100th Congress
1st Session

COMMITTEE PRINT

S. PRT.
100-65

LEADERSHIP AMENDMENT TO S. 1920, THE OMNIBUS BUDGET RECONCILIATION ACT OF 1987

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

DECEMBER 1987

Printed for the use of the Committee on the Budget

U.S. GOVERNMENT PRINTING OFFICE

80-012

WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S252-3

COMMITTEE ON THE BUDGET

LAWTON CHILES, Florida, *Chairman*

ERNEST F. HOLLINGS, South Carolina	PETE V. DOMENICI, New Mexico
J. BENNETT JOHNSTON, Louisiana	WILLIAM L. ARMSTRONG, Colorado
JIM SASSER, Tennessee	NANCY LANDON KASSEBAUM, Kansas
DONALD W. RIEGLE, JR., Michigan	RUDY BOSCHWITZ, Minnesota
J. JAMES EXON, Nebraska	STEVEN D. SYMMS, Idaho
FRANK R. LAUTENBERG, New Jersey	CHARLES E. GRASSLEY, Iowa
PAUL SIMON, Illinois	ROBERT W. KASTEN, JR., Wisconsin
TERRY SANFORD, North Carolina	DAN QUAYLE, Indiana
TIMOTHY E. WIRTH, Colorado	JOHN C. DANFORTH, Missouri
WYCHE FOWLER, JR., Georgia	DON NICKLES, Oklahoma
KENT CONRAD, North Dakota	WARREN B. RUDMAN, New Hampshire
CHRISTOPHER J. DODD, Connecticut	

RICHARD N. BRANDON, *Staff Director*
G. WILLIAM HOAGLAND, *Minority Staff Director*
W. THOMAS FOXWELL, *Director of Publications*

C O N T E N T S

Summary of provisions in leadership amendment---------- 1

Title I--Committee on Commerce, Science, and Transportation---------- 15

Title II-- Committee on Energy and Natural Resources---------- 17

Title III--Committee on Environment and Public Works---------- 19

Title IV -- Committee on Finance:
(1) Spending Provisions---------- 21
(2) Revenue Provisions---------- 31

Title V--Committee on Governmental Affairs----------111

Title VII--Committee on Veterans' Affairs----------115

Title VIII--Committee on Agriculture, Nutrition, and Forestry----------125

SUMMARY OF PROVISIONS IN LEADERSHIP AMENDMENT

The Summit agreement provides for deficit reduction of $30.2 billion in 1988 and $45.9 billion in 1989. The agreement established deficit reduction targets for defense and nondefense discretionary spending, revenues, entitlements and other direct spending programs. These savings were to be achieved through two pieces of legislation: the 1988 reconciliation bill and the continuing resolution.

The leadership amendment to S. 1920, the Senate-reported reconciliation bill, achieves the revenue and entitlement savings called for in the summit agreement. In addition, the amendment contains caps on defense and domestic spending that will result in the required savings in discretionary programs. The amendment to the underlying reconciliation bill results in total savings of $24.1 billion in 1988 and $28.0 billion in 1989. If the continuing resolution complies with the targets in the agreement, the total package will save $33.7 billion in 1988 and $46.2 billion in 1989.

The amendment contains the recommendations of the five Senate authorizing committees with jurisdiction over the areas specified in the summit agreement. These recommendations have been drafted, wherever possible, in consultation with the House committee of jurisdiction and the Administration.

RECONCILIATION -- ORIGINAL PROVISIONS:

The leadership amendment will leave intact the provisions of the Title I through Title III of S. 1920: Commerce, Science, and Transportation; Energy and Natural Resources; Environment and Public Works; as well as the previously enacted reconciliation provisions of the Banking, Housing, and Urban Affairs Committee. Some of the provisions in these titles contain user fees that may be used to reach the $400 million user fee target.

The leadership amendment strikes the remaining titles of S. 1920 and substitutes new language that achieves the summit agreement savings targets. The following summary provides a brief description of the major provisions in the leadership amendment. The attached table shows the current status of savings in the leadership package.

COMPONENTS OF LEADERSHIP AMENDMENT
($ billions)

	1988	1989	1988-89
Hard taxes	9.07	14.02	23.09
IRS compliance (net) 1/	1.60	2.90	4.50
User fees 2/	0.40	0.40	0.80
Discretionary spending 3/:			
Defense (Function 050)	5.00	8.20	13.20
Domestic discretionary	2.60	3.40	6.00
1989 effect of 1988 2% pay	0.00	2.40	2.40
Subtotal, discretionary	7.60	14.00	21.60
Entitlements and other:			
Medicare	2.00	3.50	5.51
Other finance provisions	0.22	0.17	0.39
Farm price supports 4/	1.20	1.30	2.50
GSL balances	0.23	---	0.23
Postal Service	0.83	0.93	1.76
Cash management initiative	0.00	0.01	0.01
PBGC premiums	0.39	0.51	0.90
VA origination fee extension	0.20	0.20	0.40
VA loan guarantee	0.80	1.00	1.80
VA vendee loans	0.04	0.02	0.07
Subtotal, entitlements	5.92	7.65	13.57
Debt service	1.30	3.70	5.00
DEFICIT REDUCTION UNDER GRH SCORING 5/	25.59	41.97	67.56
Asset sales	2.50	3.50	6.00
REA and RTB prepayments	5.35	---	5.35
GRAND TOTAL DEFICIT REDUCTION	33.74	46.17	79.91
DEFICIT TARGETS IN SUMMIT AGREEMENT	30.20	45.85	76.05

1/ The summit agreement provides for an increase in IRS staffing levels and a corresponding increase in revenues.
2/ The Senate-reported reconciliation bill contains user fee provisions sufficient to meet the requirements of the summit agreement. Details will be worked out in conference.
3/ The amendment contains caps on defense and nondefense discretionary spending for 1988 and 1989. Savings associated with these caps will be achieved upon enactment of final appropriations for 1988 and 1989 that comply with the agreement.
4/ Preliminary staff estimates.
5/ The debt service adjustment for this deficit calculation excludes savings from asset sales and prepayments.

Note: Detail may not add to totals due to rounding.

RECONCILIATION -- NEW PROVISIONS:

Title IV -- Finance, Spending

Medicare and Medicaid

Total Medicare savings reflected in the revised bill are $2.0 billion in 1988 and $3.5 billion in 1989.

DRG Rates

Increases Diagnostic Related Group payments for 1988 by 0.5 percent for urban hospitals, 3.7 percent for rural hospitals, and 2.7 percent for hospitals exempt from the prospective payment system.

Medical Education

Reduces indirect medical education payments to hospitals by 1.8 percent in 1988, reflecting more recent data on allowable education costs. Phases out direct medical education payments for graduates of foreign medical schools.

Periodic Interim Payments

Eliminates advance interim payments for certain hospitals with relatively high indigent admissions as of July, 1989, and shifts the last 1988 payment to 1989.

Capital

Effective January 1, 1988, Medicare capital payments would be paid at reasonable cost minus twelve percent for the remainder of 1988 and for 1989. The moratorium on incorporating hospital capital into PPS would be extended to four years.

Hospital Outpatient Departments

Eliminates return on equity payments to proprietary hospital outpatient departments, and limits aggregate payments to all hospital outpatient departments for radiology services.

Sequester Continuation

The 2.3 percent reduction in Medicare payments under the sequester currently in effect would be extended through December 31, 1987, except that the reduction would continue through January 15, 1988 for physician services and durable medical equipment.

Physician Payments and Durable Medical Equipment

Payments would be frozen for three months. On April 1, 1988, customary charges for physicians would be updated, and prevailing rates would be increased by 3.6 percent for primary care services, and 0 percent for other physician services. Reduces payments for certain surgical procedures. Sets new procedures for establishing charge levels for new physicians. Also establishes bonus 5 percent payments for physicians practicing in rural underserved areas who accept Medicare as payment in full.

Clinical Labs

Fee schedules for clinical laboratories would be rebased to reflect a five percentage point reduction.

Premiums

Extends current law provision requiring premium financing to cover 25 percent of Part B cost through 1989.

Part B Deductible

Effective January 1, 1989, the Part B deductible would be increased from $75 to $85.

Mental Health

Broadens Medicare coverage for psychiatric services and clarifies coverage of psychological services in certain hospital and outpatient settings.

Rural Concerns

Contains several Medicare provisions to examine and improve the financial viability of rural hospitals and improve access to health care in rural areas.

HMOS

Makes several changes to strengthen beneficiary protections under Medicare HMO contracts and make technical changes to HMO law.

Infant Mortality

Expands Medicaid to allow States to provide targeted coverage to pregnant women and children with incomes up to 160 percent of the Federal poverty level, with a $5 monthly premium charged between 130 and 160 percent of the poverty level, and to mandate coverage of children up to age 6.

Nursing Home Quality

Establishes additional standards for nursing home quality of care, including nursing and training requirements and protections of residents' rights.

Other Miscellaneous Health Provisions

Includes several Medicare and Medicaid provisions to provide for studies and demonstrations, improve collection of data and program administration, provide for expedited resolution of claims disputes, and enhance beneficiary protection.

Social Services and Income Security

Title XX

Increases authorization for Title XX social services block grant by $50 million for 1988 only.

Foster Care

Includes several provisions to improve eligibility and program administration for foster care.

Supplemental Security Income

Increase by $5 a month the amount that SSI individuals and couples in Medicaid institutions are allowed to keep from their monthly SSI checks for personal needs. Sets procedures for eligibility determination for those who are temporarily institutionalized, provides for continued Medicaid eligibility for certain SSI recipients, extends energy aid disregard, and makes other minor changes.

Other

Makes several additional small eligibility determination and program administration changes in SSI and AFDC, Child Support Enforcement, and Unemployment Insurance.

Pension Benefit Guaranty Corporation

Increases PBGC premiums from $8.50 to $14 per participant. Imposes a variable rate premium on underfunded pension programs equal to $6.00 per $1,000 of underfunding. Tightens rules on payment of minimum contributions, restricts granting of funding waivers and plan terminations under Chapter 11. Provides the plan with a lien against employer assets for significant unfunded liabilities under certain circumstances. Net deficit reduction of $205 million in 1988, $201 million in 1989, and $231 million in 1990. (Note that Title VI, the Labor and Human Resources

Committee provisions include changes to the PBGC that are not consistent with the Finance provisions. The final PBGC provisions will be worked out in conference.)

Debt Collection

Extends IRS refund offset authority for three years for all Federal agencies. Saves an additional $300 billion in 1988 and $425 billion in 1989.

Title IV -- Finance, Revenues and User Fees

Committee package increases revenue $9.1 billion in 1988 and $14.0 billion in 1989 as required by the Leadership agreement. The Committee further recommends increases in user fees of $335 million in 1988 and $318 million in 1989.

Employment Taxes

Expands employer share of FICA tax to include all cash tips. Requires income of inactive duty reservists, certain agricultural employees, family members and group-term life insurance to be treated as wages. Increases railroad retirement taxes and extends FUTA tax for three years. Revenues would be increased by $1.2 billion in 1988 and $1.7 billion in 1989.

Excise Taxes

Maintains 3 percent telephone excise tax through 1990. Requires collection of diesel and special motor fuels taxes on sales to retailers. Together these provisions generate additional receipts of $1.5 billion in 1988 and $2.5 billion in 1989.

Gift and Estate Taxes

Freezes current gift and estate tax rates for two years. Revenue estimates anticipate $21 million in 1988 and $176 million in 1989.

Correction of ESOP Estate Provision

Modifies ESOP estate tax provision to correct technical drafting errors incorporated as part of the 1986 Tax Reform Act. Provision also limits maximum allowable deductions to 50 percent of taxable estates and limits deductions to proceeds of sales of employer securities that are issued by domestic corporations that have no publicly traded stock outstanding. Closing loophole

generates $1.2 billion in 1988 and $1.6 billion in 1989.

Further Reform of the Tax Code

Accounting Provisions

Repeals cash method of accounting for farms with receipts over $25 million. Terminates special rule that permits taxpayers a deduction for additions to a reserve for vacation pay. Terminates installment method of accounting for dealers and requires contributions to fund pension past service liability to be subject to uniform capitalization rules. Reforms to accounting provisions increase tax collections by $5.1 billion in 1988 and $2.5 billion in 1989.

Corporate Provisions

Modifies corporate estimated tax rules to require larger estimated tax payments. Modifies computation of earnings and profits for intercorporate dividends and basis adjustment, repeals graduated tax rates for personal service corporations. Corporate provisions generate new revenues of $1.7 billion in 1988 and $1.2 billion in 1989.

Partnership Provisions

Suspends at the partnership level, losses and deductions of publicly traded limited partnerships; allows them to be used against income from that partnership with a carryforward mechanism. Reforms to partnership provisions increase taxes by $77 million in 1988 and $127 in 1989.

Miscellaneous Provisions

Eliminates child and dependent care credit for overnight camp expenses. Precludes employers from making deductible contributions to over-funded pension plan. Proposals increase taxes by $690 million in 1988 and $1.6 billion in 1989.

User Fees

Requires user fees for certain IRS services including letter rulings, determination letters, opinion letters and other written statements requested by individuals and organizations. Increases BATF occupational taxes of the Bureau of Alcohol, Tobacco and Firearms. Amends and extends current Customs Service user fee schedules. Total user fee receipts are projected at $335 million in 1988 and $318 million in 1989.

Title V -- Governmental Affairs

Federal Pay

Provides for a 2 percent pay increase in 1988 for all Federal civilian employees (except members of Congress) and for all uniformed military personnel. Delays pay raise to January in 1989 and 1990 for all civilian and all uniformed military personnel.

Cash Management

Mandates the establishment of procedures governing transfers of funds between the federal government and state governments in an effort to minimize time between the availability and outlay of federal funds for programs administered by the States. Provides for reciprocal interest payments on funds held for overlong periods of time.

Postal Service

Directs the Postal Service to pay Federal Employee Health Benefits costs for all postal annuitants and to pay for a portion of postal service retiree COLAs on an accrual basis in 1988 and 1989, while covering full costs for new retirees on a cash basis from 1990 on. Both these costs are currently subsidized by general revenues. Requires that the Postal Service delay its capital investment program and absorb FEHB costs within its overall budget to cover the costs of these reforms. Increases in postal rates, borrowing, or operating budgets would not be allowed to finance these new payments.

Title VI -- Labor and Human Resources

Guaranteed Student Loan Program savings

Directs the Department of Education to determine maximum cash reserve levels for all Guaranteed Student Loan Program guaranty agencies. Agencies deemed to hold cash reserves in excess of the Secretary's determination, based on financial guidelines established by the General Accounting Office, would be required to deduct default claim payments first from excess reserve funds.

The language would provide an appeal process for agencies able to demonstrate significant adverse consequences if they deplete cash reserves to the level determined by the Secretary. A waiver, in whole or part, could be granted. Authority under this section

would be repealed on September 30, 1989.

Savings from the plan are estimated to be $250 million in 1988.

Pension Benefit Guaranty Corporation

Increases PBGC premium from $8.50 to $25 per participant. Increases minimum funding standard for employer contributions. Limits granting of funding waivers to hardship employers and holds employers liable for termination of underfunded pension plans. Establishes certain conditions to be met to withdraw assets from pension plans and imposes excise tax if an amount in excess of permitted amount is withdrawn. (Note that Title IV, the Finance Committee provisions include changes to the PBGC that are not consistent with the Labor and Human Resources Committee provisions. The final PBGC provisions will be worked out in conference.)

Title VII -- Veterans Affairs

Increasing Cash Sales of Acquired Foreclosure Proprieties

Requires the Veterans Administration to increase the proportion of acquired foreclosure properties sold on a cash basis, rather than through a direct VA loan. Current law requires cash sales for between 25 and 40 percent of foreclosed properties. The bill requires cash sales for between 35 and 50 percent of foreclosed properties.

Repeal of Asset Sale Provision

Section 2 of P.L. 100-136, which required the sale of Veteran's Administration housing vendee loans with recourse, is repealed. Loans could then be sold without recourse.

Extension of Loan Origination Fee

The recently-lapsed Veterans Administration one percent housing loan origination fee is extended for two years.

Title VIII -- Agriculture, Nutrition, and Forestry

One percent reduction in income and price supports

Provides for an additional 1 percent reduction in the target price for the 1988 crops of wheat, feed grains, upland cotton, and rice. Reduces expenditures under the dairy price support program for 1988 by an amount equivalent to a 1 percent support price reduction. In addition, reduces the support price for wool and mohair for 1988 by 1 percent. Saves $160 million in 1988; $550 million over two years.

Loan Rate Decline

Loan rates for the 1988 crops of wheat, feed grains, upland cotton and rice may decline by 1 percent from 1987 levels. Current law would permit a 5 percent decline. The 1 percent limit applies to the 1988 crop only. Loan rates for the 1989 crop would retain the 5 percent maximum reduction. This provision results in savings of $135 million in 1988; $410 million over two years due to reductions in deficiency payments.

Whole Base Bid

Establishes a program for the 1988 and 1989 crops of wheat, feed grains, upland cotton, and rice which would permit a producer to retire his entire base acreage in exchange for a base diversion payment. Payment levels under this program will be established by a bid procedure. The program contains limitations on the amount of acreage in any county that may be retired. USDA/OMB estimates that this provision will save $310 million over two years.

Acreage Limitation Program for Feed Grains

Current law contains a 20 percent maximum acreage limitation program. This provision mandates a 5 percent increase in the maximum acreage limitation for the 1988 and 1989 crops of feed grains. This proposal would permit producers to plant soybeans, sunflowers and other oilseeds on this additional idled acres without losing historical base acreage.

In the case of the 1989 crop of feed grains, the Secretary may waive this 5 percent increase and instead provide for a 2.5 percent increase in the acreage limitation program if 1989 soybean stocks are estimated to exceed 425 million bushels. Soybeans may not, however, be planted on the 2.5 percent of the acreage base idled under such 1989 program.

Authorizes a 5 percent paid land diversion program for the 1988

and 1989 crops and establishes payment rates of $2.00 per bushel for 1988; $1.75 per bushel for 1989. However, if the Secretary does not implement the additional 5 percent acreage limitation program but instead implements the 2.5 percent program, the paid land diversion program for the 1989 crop of feed grains would be 7.5 percent with a payment rate of $1.75 per bushel.

Oilseed Marketing Loan

Mandates a marketing loan program for the 1988 and 1989 crops of soybeans, sunflowers and cottonseed. The established support price for sunflowers is 8 cents per pound.

Commercial Storage Reductions

Directs the Commodity Credit Corporation to reduce its expenditures for commercial storage, handling and transportation by $230 million over 1988 and 1989. CBO estimates that this provision will save $15 million in 1988; $40 million in 1989. USDA/OMB estimate that the same language saves $60 million in 1989; $170 million in 1989.

REA and RTB Loan Prepayments

Allows Rural Electrification Administration (REA) and Rural Telephone Bank (RTB) borrowers to prepay their guaranteed loans requiring only that a processing fee be paid. Increases contributions by $5.3 billion in 1988 relative to the sequester (GRH) baseline.

Title IX -- Miscellaneous Provisions

Defense and Domestic spending limits

The Leadership amendment contains budget authority and outlay ceilings for defense and nondefense spending for 1988 and 1989. These ceilings, which are shown in the table below, are consistent with the summit agreement.

	1988	1989
Defense (050):		
Budget authority	292.0	299.5
Outlays	285.4	294.0
Nondefense:		
Budget authority	145.1	160.3
Outlays	148.1	169.2

The outlay ceilings for nondefense discretionary spending are below the GRH baseline by $2.6 billion in 1988 and $3.4 billion in 1989; The nondefense discretionary ceilings are below the CBO baseline by $5.4 billion in 1988 and $8.1 billion in 1989.

In the Senate, these ceilings will be enforced through a three-fifths point of order that will lie against any fiscal year 1989 budget resolution that is not consistent with the agreement. In addition, the House and Senate Appropriations Committees are required to make their 302(b) subdivisions for 1989 consistent with the defense and domestic spending ceilings specified in this amendment.

Language rescinding the sequester order

The leadership amendment contains language that rescinds the sequester order issued by the President on November 20, 1987. In addition, this language restores any sequestrable resource that has been reduced or sequestered by the final order except for reductions in payments to medicare providers. The Finance Committee's recommendations specify that the reductions for physician services and durable medical equipment would continue through January 15, 1988 while all other reductions in provider payments would expire December 31, 1987.

The language makes the rescinding of the sequester order and the restoration of sequestered resources dependent upon the enactment of the 1988 continuing resolution and reconciliation bill that achieve the deficit reduction contemplated in the Summit agreement.

Submission of President's Budget

The amendment contains language changing the date for the submission of the President's budget to January 25 in 1988.

Technical amendments to the Congressional Budget Act

Other language in the amendment makes technical corrections to the Congressional Budget Act.

Asset Sales

The leadership amendment includes asset sales proposals sufficient to comply with the summit agreement. In addition to the provision in the Agriculture title on the prepayment of REA loans, the leadership amendment directs loan sales from 11 different portfolios achieving deficit reduction of $2.5 billion in 1988 and $3.5 billion in 1989.

The following table provides a summary of the specific loan sales and the savings assumed to be achieved from each.

Proposed Loan Sales
($ in millions)

	1988	1989
Loan Sales:		
Rural Housing loan sales	1,590	2,350
Rural Development Insurance Fund	0	600
HUD Community Development	120	50
College housing loans	50	0
Higher Education Facilities	50	0
Export-Import Bank	500	500
Bureau of Reclamation	130	0
HHS Medical Facilities loans	40	0
HHS Health Maintenance loans	20	0
Total loan sales	2,500	3,500

OTHER CONSIDERATIONS:

User Fees

The leadership amendment assumes that the final package will included user fees with savings of $400 million in both 1988 and 1989 and that the details will be worked out in conference. The user fee provisions may be drawn from the Finance provisions in the leadership amendment and from the provisions in the reconciliation bill as reported. The leadership amendment for the Finance Committee includes user fee provisions that would save $335 million in 1988 and $318 million in 1989. The Commerce, Science, and Transportation title, the Energy and Natural Resources title, and the Environment and Public Works title contain seven separate user fee provisions that save $404 million in 1988 and $508 million in 1989.

IRS Compliance

The leadership agreement assumes increases in revenues of $1.9 billion in 1988 resulting from increased funding of $300 million for Internal Revenue Service tax collection efforts. These savings will be accomplished through the appropriations process.

TITLE I—COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

(The leadership amendment does not affect Title I of S. 1920, the Senate-reported reconciliation bill.)

TITLE II—COMMITTEE ON ENERGY AND NATURAL RESOURCES

(The leadership amendment does not affect Title II of S. 1920, the Senate-reported reconciliation bill.)

TITLE II—COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS

(The leadership amendment does not affect Title III of S. 1920, the Senate-reported reconciliation bill.)

TITLE IV—COMMITTEE ON FINANCE

Subtitle A—Description of Spending Provisions

FINANCE COMMITTEE SPENDING PROVISION AMENDMENTS (SUBMITTED FOR INCLUSION IN THE LEADERSHIP DEFICIT REDUCTION PACKAGE)

The Committee approved the following Medicare provisions. Unless noted otherwise, the effective dates in the original Committee bill and the amendments described below would generally be January 1, 1988.

MEDICARE PART A

1. Hospital Prospective Payment System (PPS): Effective January 1, 1988, urban hospital payment rates would be increased by 0.5 percent, rural hospital payment rates by 3.7 percent, and rates for PPS-exempt hospitals by 2.7 percent. The 3.2 percentage point differential between urban and rural hospitals created in the original Committee bill would be maintained.

2. Hospital Capital: Effective January 1, 1988, Medicare capital payments would be paid at reasonable cost minus twelve percent for the remainder of FY 1988 and for FY 1989. The moratorium on incorporating hospital capital into PPS would be extended from two years in the original Committee bill to four years.

3. Direct Medical Education Payments for Foreign Medical Graduates: Effective for cost reporting periods beginning on or after July 1, 1988, Medicare direct medical education payments for graduates of foreign medical schools (other than Canada) would be phased out. For most hospitals, payments would be reduced by one-third in the first year, and two-thirds in the second year and would be eliminated in the third year. For those hospitals in which more than half the interns and residents are foreign medical graduates, a longer transition would apply--payments would be reduced by one-third in each of the first two years, two-thirds in each of the following three years, and would be eliminated thereafter. The provision would not affect indirect medical education payments.

4. Sole Community Hospitals: As in the original bill, this provision would become effective October 1, 1987. Additional volume adjustment payments made available under the original Committee bill would be capped at $10 million in FY 1988 and $12 million in FY 1989.

5. Rural Referral Centers: The eligibility threshold for rural referral center status under PPS would be reduced to 3000 discharges per year, (from the current criterion of 5000 annual discharges), but only for rural hospitals with a case mix index that exceeds both the regional and national medians for urban non-teaching hospitals. The provision would be budget-neutral.

6. Treatment of Certain Rural Hospitals as Urban Hospitals: The original Committee provision allowing certain rural hospitals to be paid urban rates under PPS would be modified, on a budget-neutral basis, to eliminate the wage-related criteria.

7. Pacemaker Warranties: Hospitals would be required to report the payments they obtain in connection with pacemaker replacements made under warranty. Medicare payments to the hospital would be reduced at the end of the year by the amount of such payments. The provision would be effective January 1, 1988.

MEDICARE PARTS A AND B

8. Continuation of Sequester Through December 31, 1987: The 2.324 percent reduction in Medicare payments under the sequester currently in effect would be extended through December 31, 1987, except that the reduction would continue through January 15, 1988 for physician services and durable medical equipment.

9. Managing Contractor Restrictions: The original Committee provision prohibiting the use of denial quotas by Medicare contractors would be modified to confirm the authority of the Secretary of HHS to manage Medicare contractors effectively.

10. Peer Review Organization Provisions: The authority of the Office of Management and Budget to apportion funds for Medicare Peer Review Organizations would be eliminated. The on-site review requirements in the original Committee bill would be modified to limit the requirement to rural hospitals and reduce the percentage of on-site reviews from 50 to 20 percent.

11. Medicare Health Maintenance Organization Provisions:

a. HMOs would be required to guarantee continuation of certain supplemental coverage in the event they terminate operations under Medicare.

b. HMOs would be required to inform beneficiaries of the possibility that the HMO's participation in Medicare will not continue indefinitely.

c. The Prospective Payment Assessment Commission, in consultation with the Physician Payment Review Commission, would be required to appoint a task force on capitation payment reform.

d. Medicare would continue to pay HMOs for disabled enrollees as disabled enrollees after they attain age 65.

e. Authority for the benefit stabilization fund would be continued for two additional years.

f. The Secretary would be required to waive the 50-50 rule for Blue Care of Michigan and HIP of New York.

MEDICARE PART B

12. Temporary Freeze on Payments for Physician Services and Durable Medical Equipment: For the first three months of calendar year 1988, Medicare payment rates for physician services and durable medical equipment would be frozen at 1987 levels. (Except that, as noted above under Item 8, for the first fifteen days of January 1988, the 2.324 percent reduction in payment amounts under the sequester currently in effect would continue to apply to these payment amounts.) In addition, the maximum allowable actual charges in effect for 1987 would be frozen for the first three months of 1988. All participation agreements in effect on December 31, 1987, would continue through March 31, 1988, unless the physician or supplier requests that the agreement be terminated. The deadline for agreements to participate in Medicare in 1988 would be extended to March 31, 1988.

13. Physician Payment Updates: On April 1, 1988, customary charges for physicians would be updated. The update in prevailing charges would be zero percent, except for primary services as defined in the original Committee provision (office, home, nursing home and emergency room visits). The update for primary services would be 3.6 percent.

14. Overpriced Procedures: The list of overpriced procedures in the original Committee bill would be expanded to include cardiac pacemaker implantation. Effective April 1, 1988, prevailing charges for these procedures would be reduced on a sliding scale basis as in the original Committee bill, except that the maximum reduction would be increased to 15 percent.

15. Clinical Lab Provisions: Effective January 1, 1988, the fee schedules for clinical laboratories would be rebased to reflect a five percentage point reduction. The limit on fee schedules, effective on January 1, 1988, would be 100 percent of the national median and, effective January 1, 1989, would be reduced to no less than 95 percent of the national median. The Secretary of HHS would be authorized to apply intermediate sanctions to clinical laboratories that fail to meet Medicare standards.

16. Part B Deductible: Effective January 1, 1989, the Part B deductible would be increased from $75 to $85.

17. Therapeutic Shoes: Medicare coverage of therapeutic shoes would be implemented, as under the original Committee bill, but only if proven cost-effective by a demonstration project.

18. Eye and Ear Hospitals: The provision in the original Committee bill would be modified to include eye specialty hospitals as well as eye and ear specialty hospitals. In addition, the threshold for qualifying for the exemption from the current law transition scheduled to begin on October 1, 1988 would be reduced from 50 percent of outpatient procedure revenue to 30 percent of outpatient service revenue.

MEDICAID

19. Infant Mortality: The bill originally reported by the Committee would be modified to reduce eligibility income limits for pregnant women and infants up to age 1 from 185 percent to 160 percent of the federal poverty level. A monthly premium of $5.00 would be charged families with incomes between 130 percent and 160 percent of the federal poverty level. Expanded coverage of children meeting Aid to Families with Dependent Children (AFDC) income and asset standards, but not eligible for AFDC payments, would be modified to mandate coverage through age six. Coverage for children through age eight would be a State option.

20. Nursing Home Quality: The nursing home quality provisions included in the original Committee bill would be modified:

a. Authority to waive the nurse staffing requirements would be granted to the State (with the Secretary maintaining "lock-behind" responsibility);

b. Minimum hours of nurse aide training would be reduced to 75 hours;

c. Persons with Alzheimer's disease or related disorders would be excluded from the pre-admission screening requirements;

d. States would be required to submit State plan amendments detailing how payments would be adjusted to meet new requirements applied to nursing homes;

e. Nursing homes would be required to provide an activities program directed by a qualified professional; and,

f. Other miscellaneous and technical changes would be made.

21. Home and Community-Based Waivers: New waiver authority provided under the original Committee bill would be modified to limit growth in annual spending on long-term care to 7, rather than 9 percent. The provision of the original Committee bill dealing with waivers awarded before March 1985 would be deleted.

22. Respite Care: Technical corrections related to the respite care pilot project in New Jersey would be included.

23. Metropolitan HMO: The six-month lock-in and guarantee currently authorized for Federally qualified HMOs would be authorized for the Metropolitan Health Plan HMO operated by the New York City public hospitals.

24. Spousal Impoverishment: The section relating to spousal impoverishment included in the original Committee bill would be deleted.

25. Medicaid Cap for Puerto Rico and Territories: The provision increasing the Medicaid cap for Puerto Rico and the Territories included in the original Committee bill would be deleted.

INCOME SECURITY AND SOCIAL SERVICES

26. Personal Needs Allowance for SSI Recipients: The original Committee bill would have increased the personal needs allowance for Supplemental Security Income recipients who are in Medicaid institutions by $5 a month (from $25 to $30), effective January 1, 1988. The effective date of the provision would be delayed for 6 months, to July 1, 1988.

27. Increase in Funding for Title XX: The entitlement cap for the title XX social services program is increased by $50 million for FY 1988, from $2.7 billion to $2.750 billion. The original Committee bill had provided for an increase of $100 million for FY 1988.

28. Assistance to Homeless AFDC Families: The Secretary of Health and Human Services would be prohibited from taking any action (by regulation or otherwise) to prevent a State, prior to October 1, 1988, from meeting the needs of homeless families with children as part of its AFDC "special needs" program. Amounts for shelter and related needs may vary according to geographic location, family circumstance, or the type of living accommodation occupied.

Senate Finance Spending Programs
Administration Estimates (Outlays in millions) 1/
(Provisions changed from original Finance bill noted with an asterisk)

	FY 1988	FY 1989
Medicare Part A		
Cash flow: Eliminate PIP for Disp. Share	0	(480)
Indirect Medical Education *	(340)	(550)
Prospective Payment System Update *	(410)	(430)
Capital Payments reduction *	(180)	(110)
Sole Community hospital increase *	10	12
Phase out payment for foreign med. grads *	(5)	(40)
Extend GRH through 12/31/87 *	(120)	0
Medicare Parts A and B		
Cash Flow: Payment Cycle Floors	(530)	(190)
NHSC loan collection	(12)	(16)
Payment Safeguard Add-on	10	10
Minor Provisions *	1	5
Peer Review Organization Requirements *	5	20
Medicare Part B		
Payments for New physicians	(30)	(90)
Outpatient Radiology	0	(40)
Eliminate ROE for outpatient departments	(20)	(40)
Increase Mental Health limit to $1100	50	90
Bonus for rural physicians	0	5
More coverage of physician assistants	0	0
Part B premium extension 1/	0	(860)
Medicare Economic Index and MD prices *	(180)	(380)
Overpriced physician procedures *	(20)	(50)
Durable Medical Equipment (DME) *	(30)	(50)
Clinical lab limits *	(100)	(190)
Change Part B Deductible to $85 in FY89 *	0	(130)
Therapeutic Shoes *	0	0
Extend GRH through 12/31/87 for all Part B, through 1/15/88 for physicians and DME *	(100)	0
Total Medicare	(2,001)	(3,504)
Medicaid		
Nursing Home Quality *	6	95
Infant Mortality *	0	155
HCBW Revisions *	0	0
Quality Control Moratorium and Other	13	(13)
Income Security		
Title XX (Social services) *	48	2
Infant Foster Care	5	6
Personal Needs Allowance *	3	13
Other	1	3
Total Net Entitlement Savings	(1,925)	(3,243)

1/ Estimates reflect changed effective dates and interactions within the Medicare program. Gross spending estimates are reflected for Part B provisons. Premium effects of all Part B items is reflected in the Part B premium estimate.

80-012 O - 87 - 2

TITLE IV—COMMITTEE ON FINANCE

Subtitle B—Description of Revenue Provisions

SUBTITLE B: DESCRIPTION OF REVENUE PROVISIONS

A. ACCOUNTING PROVISIONS

1. Repeal of Vacation Pay Reserve (sec. 4501 of the bill [1] and sec. 463 of the Code)

Present Law

Under present law, an accrual method taxpayer generally is permitted a deduction for the taxable year in which all the events have occurred that determine the fact of a liability and the amount thereof can be determined with reasonable accuracy (the "all events" test). In determining whether an amount has been incurred with respect to any item during the taxable year, all events that establish liability for such amount are not treated as having occurred any earlier than the time economic performance occurs (sec. 461(h)). With respect to a liability that arises as a result of another person's providing services to the taxpayer (such as the liability to provide vacation pay in exchange for services by an employee), economic performance generally occurs when such other person provides the services.

In order to ensure the proper matching of income and deductions in the case of deferred benefits (such as vacation pay earned in the current taxable year, but paid in a subsequent year) for employees, an employer generally is entitled to claim a deduction for the taxable year of the employer in which ends the taxable year of the employee in which the benefit is includible in gross income (sec. 404(b)). This rule applies to deferred benefits without regard to the economic performance rules. Consequently, an employer is entitled to a deduction for vacation pay for the taxable year of the employer in which ends the earlier of the taxable year of the employee for which the vacation pay (1) vests (if the vacation pay plan is funded by the employer), or (2) is paid.

An exception to this rule applies to amounts that are paid within 2-1/2 months after the close of the taxable year of the employer in which the vacation pay is earned. Such amounts are not subject to the deduction-timing rules applicable to deferred benefits, but are subject to the general rules under which an employer is entitled to a deduction when economic performance occurs (i.e., when the services of the employee for which vacation pay is earned are performed). Amounts paid within 2-1/2 months after the close of the employer's taxable year in which the all events test and the economic performance requirement are satisfied generally will be deductible for the such taxable year even though the employee does not include the benefit in income for such taxable year.

---

[1] In the headings throughout this explanation, section citations to the bill refer to the bill as it would be amended by the leadership amendment.

Under a special rule of present law, an employer may make an election under section 463 to deduct an amount representing a reasonable addition to a reserve account for vacation pay (contingent or vested) that is paid during the current taxable year or within 8-1/2 months after the close of the taxable year of the employer with respect to which the vacation pay was earned by the employees.

Reasons for Change

The special rules under present law relating to the reserve for accrued vacation pay create a disparity in tax treatment between accrued vacation pay and other deferred benefits. The timing of deductions for vacation pay should not be more favorable than the timing of deductions for other deferred benefits.

Explanation of Provision

The special rule that permits taxpayers a deduction for additions to a reserve for vacation pay would be repealed. Accordingly, under the amendment, deductions for vacation pay generally would be allowed in any taxable year for amounts paid during the year plus vested vacation amounts paid or funded within 2-1/2 months after the end of the year.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987. A change from the reserve method of accounting for vacation pay to the method required by the amendment is treated as a change in method of accounting that is initiated by the taxpayer and made with the consent of the Secretary of the Treasury. The net amount of the adjustment required by the change in method of accounting is required to be taken into account over a period not to exceed 4 taxable years. The amendment specifies the percentage of the adjustment that is required to be taken into account for each taxable year in the 4-year period. If Rev. Proc. 84-74, 1984-2 C.B. 736, would require the adjustment to be taken into account over a period of less than 4 taxable years, the adjustment is to be taken into account ratably over the shorter period.

2. Repeal of Installment Method for Dealers (sec. 4502 of the bill and secs. 453, 453A, and 453C of the Code)

Present Law

Under present law, a taxpayer who sells property ordinarily must recognize gain or loss at the time of the sale. However, a taxpayer who is eligible to use the installment method may defer the payment of tax and recognize gain from a sale of property in proportion to the payments received.

In general, the installment method may be used to report gain from the sale of personal property by dealers in personal property who regularly sell on the installment plan or from the sale of other property where at least one payment is to be made after the end of the taxable year of the sale.

Under the installment method, in any taxable year, a taxpayer recognizes income resulting from a disposition of property equal to an amount that bears the same ratio to the payments received in that year that the gross profit under the contract bears to the total contract price ("the gross profit ratio"). Payments taken into account for this purpose generally include cash or other property (including foreign currency and obligations of third parties), marketable securities, certain assumptions of liabilities, and evidences of indebtedness of the purchaser that are payable on demand or are readily tradable.

Use of the installment method generally is limited under the so-called "proportionate disallowance rule" for dealer sales of real property and dealer sales of personal property eligible to be reported on the installment method, as well as for sales of real property used in the taxpayer's trade or business or held for the production of rental income where the selling price of such real property is greater than $150,000. Under the proportionate disallowance rule, a pro rata portion of the taxpayer's indebtedness is allocated to, and is treated as a payment on, the installment obligations of the taxpayer.

Use of the installment method is not allowed for sales pursuant to a revolving credit plan and for sales of publicly traded property. In addition, the installment method may not be used for purposes of the alternative minimum tax for sales that are subject to the proportionate disallowance rule.

At the election of the seller, installment obligations arising from certain sales of residential lots and "timeshares" are not subject to the proportionate disallowance rule. Rather, such taxpayers may compute their tax liability under the installment method and are required to pay interest on the amount of deferred tax attributable to the use of the installment method. In addition, the installment method may be used for purposes of the alternative minimum tax for sales of residential lots and "timeshares" if interest is paid on the amount of the deferred tax.

Reasons for Change

In general, the underlying reason for allowing the reporting of gain on the installment method for Federal income tax purposes is that the seller may be unable to pay tax currently because no cash may be available until payments under the installment obligation are received. It is believed that dealer sales of property for notes or accounts receivable do not create the significant cash-flow problems that the installment method is designed to alleviate because a dealer generally is able to finance receivables. The repeal of the installment method for dealer sales will end the ability of a dealer to defer tax on a sale of property by taking back a note or account receivable that is payable in a future year.

Explanation of Provision

The amendment repeals the installment method for dispositions of property by dealers ("dealer dispositions") effective for dispositions occurring after December 31, 1987. Generally, all payments to

be received from a dealer disposition of property are treated as received in the year of disposition.

A dealer disposition is defined for purposes of the repeal of the installment method as any disposition of personal property by a person who regularly sells or otherwise disposes of property on the installment plan. A dealer disposition also includes any disposition of real property that is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business. A dealer disposition does not, however, include certain dispositions of residential lots or "timeshares" if the taxpayer elects to pay interest on the amount of deferred tax attributable to the use of the installment method. Additionally, a dealer disposition does not include a disposition of property used or produced in the trade or business of farming.

The installment method rules applicable to dispositions of residential lots or "timeshares" with respect to which interest is paid or dispositions of property used or produced in the trade or business of farming are not affected by the amendment. Thus, a disposition of such property on the installment plan will be subject to the current rules applicable to dealers using the installment method.

Effective Date

The repeal of the installment method for dealer dispositions is effective for dispositions occurring after December 31, 1987. The treatment of an installment obligation arising out of a dealer disposition occurring before March 1, 1986, is not affected by this provision.

An applicable installment obligation arising out of a dealer disposition occurring after February 28, 1986, and before January 1, 1988, is subject to the proportionate disallowance rule for taxable years ending after December 31, 1986, and beginning before January 1, 1988. Any gain from an installment obligation arising out of a dealer disposition occurring after February 28, 1986, and before January 1, 1988, that remains to be recognized as of the first day of the first taxable year beginning after December 31, 1987, is not to be recognized as payments are received (or treated as received under the proportionate disallowance rule) in a later taxable year. Instead, the amount of the gain that remains to be recognized from such installment obligations is to be taken into account as a section 481(a) adjustment. The amount of the section 481(a) adjustment is to be taken into account under the principles of Rev. Proc. 84-74, 1984-2 C.B. 736, but the adjustment period generally is 4 taxable years rather than 6 taxable years. In determining the period that the adjustment is to be taken into account, the application of the proportionate disallowance rule is not to be treated as a new method of accounting.

The amendment does not affect the transition relief provided at the time the proportionate disallowance rule was enacted.

3. Treatment of Past Service Pension Costs Under Uniform Capitalization Rules (sec. 4503 of the bill and sec. 263A of the Code)

Present Law

In general, uniform capitalization rules govern the inclusion in inventory or capital accounts of all costs incurred in manufacturing, construction, and other types of activities involving the production of real or tangible personal property, or incurred in acquiring or holding property for resale. In the legislation mandating a uniform set of capitalization rules, Congress directed the Treasury Department to model the regulations implementing these rules after the regulations issued under section 451, dealing with capitalization of costs in connection with extended period long-term contracts.

The extended period long-term contract regulations require capitalization of all direct costs and an allocable portion of indirect costs such as general and administrative and overhead costs. Temporary and proposed regulations issued by the Treasury Department provide that contributions to a pension or annuity plan are not subject to the uniform capitalization rules to the extent they represent past service costs within the meaning of section 412 (containing rules for actuarial funding of pension plans).[2] Such costs are, subject to other limitations in the Code, currently deductible. If the taxpayer's actuarial funding method does not distinguish between current and past service costs, all pension costs must be treated as current service costs, which are subject to capitalization.

Reasons for Change

For purposes of the uniform capitalization rules, pension costs incurred by a taxpayer that are deemed to relate to past services under the Code's actuarial funding rules should be treated in the same manner as costs deemed to relate to current services. Both types of costs are costs that are necessarily recovered out of the proceeds from the sale of property produced or held in the year the costs are incurred. Thus, consistent with the uniform capitalization rules' objective of matching expenses with the related income, past as well as current service costs should be subject to capitalization.

Explanation of Provision

Under the amendment, past service costs will be subject to the uniform capitalization rules. Thus, an allocable portion of all otherwise deductible pension costs, whether relating to current or past services, will be included in the basis of the property that is produced or held for resale.

Effective Date

The provision will apply to taxable years beginning after December 31, 1987. The amount of any section 481 adjustment required by the amendment (that is, the adjustment reflecting pension costs

---

[2] Temp. and Prop. Reg. sec. 1.263A-1(b)(2)(v)(H)(1).

deducted by a taxpayer in taxable years beginning before January 1, 1988) must be included in income over a period not exceeding four years.

4. Certain Farm Corporations Required to Use the Accrual Method of Accounting (sec. 4504 of the bill and sec. 447 of the Code)

Present Law

Entities engaged in the trade or business of farming generally may use the cash method of accounting for such trade or business. A corporation, or a partnership with a C corporation as a partner, that has gross receipts in excess of $1 million for any taxable year beginning after 1975 must use an accrual method of accounting, unless it is a "family corporation" (sec 447). In general, a "family corporation" is a corporation 50 percent or more of whose stock is owned by members of the same family (sec. 447(c)(2)). Certain closely-held corporations substantially owned by two or three families on October 4, 1976, and at all times thereafter also qualify as a "family corporation" (sec. 447(h)).

A tax shelter engaged in the trade or business of farming may not use the cash method of accounting, regardless of whether or not it also is a "family corporation."

Reasons for Change

It is felt that any corporation, or partnership with a C corporation as a partner, that is engaged in the trade or business of farming and that has gross receipts in excess of $25 million should be required to use the accrual method of accounting. It is believed that an accrual method of accounting will more accurately reflect the income of such an entity; and that such large entities, whether closely held or not, are sufficiently sophisticated to keep their books and records using an accrual method.

Explanation of Provision

In general

A family corporation is required to use an accrual method of accounting unless, for each prior taxable year beginning after December 31, 1985, such corporation (and any predecessor corporation) did not have gross receipts exceeding $25 million. Gross receipts for any taxable year which is a year of less than 12 months must be annualized in order to determine if they exceed $25 million. A family corporation includes those family-owned corporations and those closely held corporations that are not required by present law to use the accrual method of accounting, regardless of size (sec. 447(c)(2) and sec. 447(h) of present law).

Attribution rules

In determining the amount of gross receipts of a family corporation, certain attribution rules apply. In the case of a family corporation that is part of a controlled group (within the meaning of sec. 1563(a)), a percentage of the gross receipts for the taxable year of

other members of such controlled group may be allocated to the family corporation. The percentage used in allocating such gross receipts is equal to the percentage of the fair market value of stock in such other member held directly or indirectly by the family corporation on the last day of the taxable year of such other member. For this purpose, stock excluded under section 1563(c) is not considered.

For example, a father and his son own 100 percent of Corporation A (a family corporation) and 60 percent of Corporation B. Corporation A owns an additional 20 percent of Corporation B. The remaining 20 percent of Corporation B is held by an unrelated party. Corporation A and Corporation B are members of the same controlled group. Eighty percent (20 percent direct ownership and 60 percent indirect ownership) of the gross receipts of Corporation B will be included with the gross receipts of Corporation A for the purpose of determining whether Corporation A has gross receipts in excess of $25 million.

It is not intended that the attribution of gross receipts from one member of a controlled group to another member result in such receipts being taken into account more than once. It is anticipated that the Secretary of the Treasury will issue regulations accomplishing this result. For example, assume that Corporation A in the example in the preceding paragraph sells a calf to Corporation B for $100. Corporation B feeds the calf and sells it to unrelated parties for $250. The gross receipts of Corporation B attributable to Corporation A from this transaction would be 80 percent of the difference between $250 and $100, since the $100 of receipts attributable to that stage of the calf's development while held by Corporation A already is being taken into account in the gross receipts of Corporation A.

If a family corporation owns, directly or indirectly, any interest in a partnership, estate, trust, or other pass-through entity, the family corporation must take into account its proportionate share of the gross receipts of such a pass-through entity in determining the gross receipts of the family corporation.

Suspense account

If any family corporation is required by this provision to change its method of accounting, such corporation shall not be required to take into income so much of the adjustment under section 481 as is used to establish the opening balance of a suspense account. The initial opening balance of the suspense account is the lesser of the net adjustment that otherwise would have been required to be taken into account under section 481 as of the beginning of the year of change or the amount of such net adjustment determined as if the change were made as of the beginning of the preceding taxable year. The portion of the adjustment under section 481 that is not used to establish the suspense account is taken into income in the year of change.

For example, a calendar year family corporation is required to change to the accrual method of accounting effective for its taxable year beginning January 1, 1988. The net adjustment under section 481 as of January 1, 1988 is $100,000. The net adjustment adjustment under section 481 as of January 1, 1987 was $95,000. The

opening balance of the suspense account will be $95,000 and $5,000 ($100,000 - $95,000) will be required to be included in income in the taxable year beginning January 1, 1988.

The amount placed in the suspense account is required to be taken into income upon the occurrence of certain events. If the taxpayer fails to meet the definition of a family corporation, the amount of the suspense account is to be taken into income in the taxable year in which the corporation ceases to be a family corporation. Also, if the gross receipts of the corporation attributable to farming for any taxable year decline to an amount below the gross receipts attributable to farming for the last taxable year for which the cash method of accounting was allowed, a portion of the suspense account may be taken into income.[3] The portion to be taken into income is equal to the current balance of the suspense account multiplied by a fraction the numerator of which is the gross receipts for the current taxable year and the denominator of which is the lesser of (a) the gross receipts of the taxpayer for the taxable year preceeding the year of change or (b) the gross receipts for the most recent year in which a portion of the suspense account was taken into income under this rule.

Effective Date

The provision is effective for taxable years beginning after December 31, 1987.

[3] For this purpose, gross receipts from taxable years of less than 12 months will be annualized.

B. ESTIMATED TAX PROVISIONS

(Secs. 4511-4513 of the bill, sec. 1541 of the Reform Act, and secs. 3402, 6654, and 6655 of the Code)

1. Corporate Estimated Tax Reform (sec. 4511 of the bill)

Present Law

Under present law, a corporation that fails to pay an installment of estimated income tax on or before the due date generally is subject to a penalty computed at the rate of interest for tax underpayments. The penalty may not be waived. The penalty is computed by applying the underpayment interest rate to the amount of the underpayment of the installment for the period of the underpayment. The amount of the underpayment is the difference between the payments made on or before the due date of each installment and 90 percent of the total tax shown on the return for the year, divided by the number of installments that should have been made. The penalty on underpayments of estimated tax that are between 80 percent and 90 percent of the actual tax due is imposed at three-quarters of the full rate.

There are three exceptions to the penalty. No penalty is imposed upon a corporation if total tax payments for the year equal or exceed installments based on (1) the preceding year's tax liability, if a return showing a liability for tax was filed for the preceding year; (2) the tax computed by using the facts shown on the prior year's return under the current year's tax rates; or (3) 90 percent of the taxes which would be due if certain income already received during the current year was annualized. Large corporations may not use exceptions (1) and (2) described above. A large corporation is defined as a corporation having at least $1 million of taxable income in any of the three prior taxable years. No penalty is imposed where the tax is less than $40.

Reasons for Change

Although the individual estimated tax rules were consolidated and simplified in 1984, no similar consolidation and simplification was done for the corporate estimated tax rules; it is appropriate to do so at this point. Also, because of the difficulties many large corporations experience in computing accurately their estimated tax payments for the first quarter, it is appropriate to provide for them for that quarterly payment the same safe harbor that is currently available to small corporations.

Explanation of Provision

The amendment consolidates all the corporate estimated tax rules into one section of the Code, similar to the provision enacted

for individuals in 1984. Also, several modifications are made to present law.

The underpayment penalty with respect to any installment applies to the difference between payments made by the due date of the installment and the lesser of an installment based on (1) 90 percent of the tax shown on the return; or (2) 100 percent of the tax shown on the preceding year's return. As under present law, exception (2) generally does not apply to a large corporation, except that a large corporation can use that exception for purposes of making its first estimated tax payment for any taxable year. Thus, both large and small corporations may base their first estimated tax payment of any taxable year upon 100 percent of the tax shown on the preceding year's return. A special transition rule provides that, for taxable years beginning in 1988 only, a large corporation can use that exception for purposes of making its first and second estimated tax payments. In determining whether a corporation is a large corporation (i.e., whether its taxable income exceeds $1 million), net operating loss and capital loss carryforwards and carrybacks are disregarded. The safe harbor based on the previous year's facts and the current year's rates is eliminated.

In addition, the full rate of the penalty is imposed with respect to any payment only to the extent the total payments for the year up to the required installment are below 90 percent of the taxes which would be due if the income already received during the current year was placed on an annual basis. Thus, the "cliff" effect of the penalty under present law is eliminated. Additionally, the reduced rate of the penalty for underpayments that are between 80 and 90 percent is eliminated. Any reduction in an estimated tax payment or payments resulting from using the annualization exception must be made up in the next payment in that taxable year for which the corporation does not use the annualization exception.

Finally, no penalty is imposed if the tax for any taxable year is less than $500.

Effective Date

This provision applies to taxable years beginning after December 31, 1987.

2. Revised Withholding Certificates Required to be Put Into Effect More Promptly (sec. 4512 of the bill)

Present Law

If an employee furnishes to his or her employer a withholding allowance certificate (Form W-4 or W-4A) that replaces an existing certificate, the employer must make the certificate effective no later than the first status determination date that is at least 30 days after the date the employee furnishes the certificate to the employer. The status determination dates are January 1, May 1, July 1, and October 1 of each year. For example, if an employee furnishes a replacement withholding allowance certificate to his or her employer on June 2, the employer must make that certificate effective no later than October 1.

Employers may elect to make replacement certificates effective earlier than they are required to statutorily; most employers elect to do so.

Reasons for Change

It is appropriate to reduce the amount of time before a replacement withholding certificate must become effective.

Explanation of Provision

Employers will be required to give effect to replacement withholding allowance certificates (Form W-4 or W-4A) no later than the start of the first payroll period ending on or after the thirtieth day after the day on which the employee furnishes the certificate to the employer. Employers are permitted to continue to elect to give effect to replacement withholding allowance certificates on any date between the date it is furnished by the employee and the statutorily mandated effective date.

Effective Date

The provision applies to replacement withholding allowance certificates furnished after the day 30 days after the date of enactment of the bill.

3. Estimated Tax Penalties for 1987 (sec. 4513 of the bill)

a. Delay of increase in current year liability test for individuals

Present Law

Individuals owing income tax who do not make estimated tax payments are generally subject to a penalty (Code sec. 6654). In order to avoid the penalty, individuals must make quarterly estimated tax payments that equal at least the lesser of 100 percent of the prior year's tax liability or 90 percent of the current year's tax liability. Amounts withheld from wages are considered to be estimated tax payments.

The Tax Reform Act of 1986 increased from 80 to 90 percent the proportion of the current year's tax liability that taxpayers must pay to avoid the penalty. This was effective for taxable years beginning after December 31, 1986.

Reasons For Change

It is appropriate to modify the estimated tax rules for individuals for 1987, due to the difficulties a number of individuals had with Form W-4 and with other provisions of the 1986 Act.

Explanation of Provision

The amendment delays for one year this increase from 80 to 90 percent. Thus, for taxable years beginning before January 1, 1988, individuals may avoid the estimated tax penalty by making quarterly estimated tax payments that equal at least the lesser of 100 percent of the prior year's tax liability or 80 percent of current

year's tax liability. For taxable years beginning after December 31, 1987, individuals may avoid the estimated tax penalty by making quarterly estimated tax payments that equal at least the lesser of 100 percent of the prior year's tax liability or 90 percent of the current year's tax liability.

Effective Date

The increase from 80 to 90 percent is effective for taxable years beginning after December 31, 1987 (instead of taxable years beginning after December 31, 1986).

b. Corporations may use 1986 tax to determine certain estimated tax installments due before July 1, 1987

Present Law

No estimated tax penalty is imposed upon a corporation with respect to any installment if that installment plus all prior installments for the year are based on the lesser of (1) the preceding year's tax liability, if a return showing a liability for tax was filed for the preceding year; (2) the tax computed by using the facts shown on the prior year's return under the current year's tax rates; or (3) 90 percent of the taxes which would be due if certain income already received during the current year were placed on an annual basis. Large corporations may not use exceptions (1) and (2) described above. A large corporation is defined as a corporation having at least $1 million of taxable income in any of the three prior taxable years.

Present law does not give explicit authority to the Treasury to provide alternative estimated tax rules for corporations.

The Treasury has issued regulations, applicable to estimated tax payments due before July 1, 1987, that permit corporations to base those estimated payments on 120 percent of 1986 taxable income with certain modifications.

Reasons for Change

Because of the numerous changes made by the Tax Reform Act of 1986, some corporations had difficulty in accurately computing their estimated tax payments for the first part of 1987. Therefore, it is appropriate to modify the estimated tax penalties for those payments.

Explanation of Provision

Two safe harbors are provided for corporate estimated tax payments due before July 1, 1987. First, all corporations, including large corporations, are permitted to base those estimated tax payments on 100 percent of the 1986 tax liability. Second, statutory authorization is provided for the safe harbor provided in the Treasury regulations.

Under the first safe harbor, no penalty for the underpayment of estimated tax for a taxable year beginning in 1987 will be imposed on a large corporation (as defined in sec. 6655(i)(2) of the Code) for any payment due on or before June 15, 1987, if the corporation's

estimated tax payments meet the present law requirements (of sec. 6655(d)(1)) applicable to other corporations allowing payments to be based on the tax shown on the prior year's return. Thus, large corporations are expressly authorized to utilize the estimated tax safe harbor of paying the preceding year's tax liability for estimated tax installments for taxable year 1987 due on or before June 15, 1987. A corporation may take advantage of this rule only to the extent that the underpayment of estimated tax is paid on or before the last date prescribed for payment of the most recent installment of estimated tax due on or before September 15, 1987. This relief is available for the first two payments of a calendar year corporation and for the first payment of a fiscal year corporation whose taxable year begins on or before March 1, 1987.

Thus, a calendar year corporation may avoid an estimated tax penalty by making the April 15 and June 15 installments based on 100 percent of the preceding year's liability and by making the September 15 installment based on 90 percent of the current year's tax liability (and by paying any shortfall from prior payments attributable to the difference between the 100 percent test and the 90 percent test as part of the September 15 installment).

Effective Date

The provisions are effective for corporate estimated tax installments for 1987 that were due before July 1, 1987.

C. CORPORATE TAX PROVISIONS

1. Certain Earnings and Profits Adjustments Not To Apply For Certain Purposes (Overrule *Woods Investment Co.*) (sec. 4521 of the bill and secs. 1503 and 301(f) of the Code)

Present Law

In general, an affiliated group of corporations may elect to file a consolidated return that aggregates the income and deductions of the common parent and its subsidiaries. An affiliated group generally includes a domestic corporation and its domestic subsidiaries connected in a chain of at least 80-percent ownership. The Code grants the Treasury Department broad authority to issue regulations governing the computation of the tax liability of an affiliated group of corporations filing a consolidated return.

In 1966, the Treasury Department issued revised consolidated return regulations requiring adjustment of a parent corporation's basis in the stock of a subsidiary by reference to changes in the earnings and profits of the subsidiary. The regulations require a parent corporation to increase its basis in the stock of a subsidiary by the amount of the undistributed net earning and profits of the subsidiary for the taxable year, and to reduce its basis in such stock by the amount of any deficit in earnings and profits, among other adjustments. At the time these regulations were issued, differences between earnings and profits and taxable income were essentially permanent as opposed to timing differences. The result was that adjustments to basis of the assets of a subsidiary were reflected immediately as adjustments to the parent corporation's basis in the stock of the subsidiary.

Subsequently, Congress enacted amendments to the provisions of the Code defining earnings and profits. As a result of these amendments, certain deferral amounts affected earnings and profits at a different rate than they affected a corporation's taxable income. For example, earnings and profits were reduced only by the amount of straight-line depreciation, even though accelerated depreciation was used for purposes of computing taxable income. Similarly, gain reported on the installment method and income reported under the completed contract method were included in earnings and profits at a faster rate than for taxable income purposes.

The purpose of these amendments to the definition of earnings and profits was to prevent corporations with economic profits from making distributions to individual shareholders that would otherwise constitute tax-free returns of capital, or capital gains taxed at a preferential rate, to the shareholder. In a consolidated return context, however, the effect of applying these amendments in computing basis adjustments was to create a disparity between the rate at which these items reduced or increased a parent's basis in the

stock of its subsidiary and the rate they reduced or increased the group's consolidated taxable income. Because of these earnings and profits adjustments, a parent corporation could sell stock in a subsidiary and recognize an artificially reduced gain, or an artificial loss.

In *Woods Investment Co.* v. *Commissioner*, 85 T.C. 274 (1985), the Tax Court rejected the Internal Revenue Service's argument that the taxpayer should not be allowed to apply these amendments for purposes of computing basis adjustments because the effect was to allow the taxpayer a double deduction. The court held the Service was bound by a literal application of the statutory definition of earnings and profits and its own regulations requiring basis adjustments based on earnings and profits. The Service subsequently announced that it would not appeal this decision and would not reassert the position taken in *Woods* against other taxpayers (Announcement 86-32). It nonetheless took the position that its position in *Woods* was correct, and stated that it was considering modification of the consolidated return regulations to prevent understatement of gain in that situation and other situations.

A similar issue arises in a consolidated return context where an insolvent subsidiary realizes cancellation of indebtedness income. The earnings and profits of the subsidiary may be increased by the amount of such income, even though the income is excluded from the subsidiary's taxable income. If so, the parent corporation's basis in the stock is increased (or its "excess loss account" or negative basis is reduced) by an amount that has not been reflected in consolidated taxable income.

A benefit similar to that at issue in the *Woods* case may exist where the distributor and distributee do not file a consolidated return.

Special rules prevent the occurrence of these distortions in certain circumstances.[4] If a 20-percent or more corporate shareholder receives a distribution from another corporation that would otherwise qualify for the dividends received deduction, the taxable income of the shareholder (and its adjusted basis in the stock of the distributing corporation) is determined by ignoring certain adjustments otherwise required in determining the earning and profits of the distributing corporation (sec. 301(f)). That is, the earnings and profits treatment of the items is conformed to the taxable income treatment. These special conformity rules do not apply, however, to depreciation.

Reasons for Change

The present consolidated return regulations, as applied in the *Woods* case, confer an unwarranted and unintended tax benefit. Under present law, the adjustment in the basis of a subsidiary's stock fails to account for the tax benefits realized by the consolidated group during the subsidiary's affiliation and also fails to require the group to pay tax on the economic profit received when a subsidiary is sold. The purpose of the statutory changes to the earn-

[4] It is unclear whether and to what extent these special rules apply in a consolidated return context, but it is understood that taxpayers generally take the position they do not.

ings and profits provisions was to ensure that distributions of economic profits that exceeded taxable income would be taxed to individual shareholders as dividends. Providing a corresponding basis adjustment for purposes of determining gain or loss on a sale of the stock is inappropriate.

The provision of present law modifying the definition of earnings and profits in the case of distributions to 20-percent or more corporate shareholders should appropriately apply to depreciation as well as to the items specified in section 312(n).

Explanation of Provision

Under the amendment, solely for purposes of determining gain or loss on disposition, a parent corporation's basis in the stock of a subsidiary with which it files a consolidated return is to be determined by computing earnings and profits of the subsidiary without regard to sections 312(k) and (n) or any prior corresponding provision. Thus, the parent's basis for purposes of determining gain or loss on disposition of the stock will be computed as if, throughout the period of the subsidiary consolidation with the parent, the subsidiary's earnings and profits had been computed without regard to the special adjustments for depreciation and other items.[5]

In addition, the amendment provides that earnings and profits for this purpose does not include any cancellation of indebtedness income of the subsidiary excluded under section 108 to the extent such income did not reduce basis of property or other tax attributes. No inference is intended as to prior law.

Finally, the amendment expands the provision modifying the definition of earnings and profits in the case of distributions to a 20-percent or more corporate shareholder to include adjustments for accelerated depreciation. It is intended that this provision (sec. 301(f)) will apply only where the distribution is between corporations not filing a consolidated return.

Effective Date

The amendment to the rules relating to adjustments in the stock in a consolidated subsidiary generally applies to stock disposed of after October 15, 1987. However, the amendment does not apply to dispositions pursuant to a written contract binding on October 16, provided the disposition is completed before January 1, 1989. The computation of gain or loss on dispositions subject to the provision will thus be computed taking into account the principles of the amendment during the entire period the subsidiary filed a consolidated return with the selling corporation, regardless of whether the subsidiary filed a consolidated return with the selling corporation in the year of the disposition or was eligible to do so.

The amendment to section 301(f) generally applies to distributions after October 15, 1987. However, the amendment does not apply for purposes of determining gain or loss on a disposition of

---

[5] These modifications to the rules for determining earnings and profits for investment adjustment purposes are not intended to affect the authority of the Treasury Department to require in the consolidated regulations that earnings and profits (computed under the general rules of section 312) be deemed distributed up the entire chain of affiliated corporations to the common parent on an annual basis.

the stock, in the case of dispositions pursuant to a written contract binding on October 16, provided the disposition is completed before January 1, 1989. For purposes of determining the earnings and profits after October 16 in the case of dispositions subject to the amendment, the amendment is deemed to have been in effect for all prior periods, whether before, on, or after that date. However, the amendment does not affect the determination whether any distribution on or before October 16, 1987, was a dividend, or the amount of any reduction in accumulated earnings and profits on account of any such distribution.

2. Benefits of Graduated Corporate Rates Not Allowed To Personal Service Corporations (sec. 4522 of the bill and sec. 11 of the Code)

Present Law

Under present law, corporations are subject to a tax at the rate of 34 percent. However, for corporations with taxable income below $335,000, graduated rates are provided. These rates are 15 percent on taxable income not over $50,000, and 25 percent on taxable income over $50,000 but not over $75,000, with the benefits of these lower rates phased out as taxable income increases from $100,000 to $335,000.

Reasons for Change

The personal service income of corporations owned by its employees is taxed to the employee-owners at the individual graduated rates as it is paid out as salary. It is inappropriate to allow the retained earnings to be taxed at the lower corporate graduated rates.

Explanation of Provision

The taxable income of a personal service corporation (as defined in section 448(d)(2) relating to the cash method of accounting) will be taxed at a flat rate of 34 percent. For this purpose, a personal sevice corporation is a corporation substantially all the activites of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all the stock of which is held by the employees performing services for the corporation.

Effective Date

The provision applies to taxable years beginning after December 31, 1987.

D. PARTNERSHIP PROVISIONS

1. Treatment of Publicly Traded Partnerships Under the Passive Loss Rule (sec. 4531 of the bill and sec. 469 of the Code)

Present Law

Under present law, deductions from passive trade or business activities (within the meaning of the passive loss rule (sec. 469)), to the extent they exceed income from such passive activities, generally may not be deducted against other income. Similarly, credits from passive activities generally are limited to the tax attributable to the passive activities. Suspended losses and credits are carried forward and treated as deductions and credits from passive activities in the next year. Suspended losses from an activity are allowed in full when the taxpayer disposes of his entire interest in the activity.

Income from passive activities does not include income such as compensation for services or portfolio income (including interest, dividends, royalties, annuities, and gains from the sale of property held for investment). For this purpose, property held for investment generally does not include an interest in a passive activity.

A passive activity generally is an activity involving the conduct of a trade or business in which the taxpayer does not materially participate. Present law provides that, except as provided in regulations, no interest in a limited partnership as a limited partner is treated as an interest with respect to which the taxpayer materially participates. Present law also provides Treasury regulatory authority to issue regulations requiring net income or gain from a limited partnership to be treated as not from a passive activity. Thus, except to the extent that the Treasury Department may provide in regulations, income from limited partnerships, including publicly traded limited partnerships, may be offset by passive losses from other sources.

Reasons for Change

It is believed that the return on investment in a publicly traded partnership is essentially comparable to the return on other portfolio investments. Under the passive loss rule, passive losses cannot be applied to offset portfolio income such as interest, dividends, annuities or royalties not derived in the ordinary course of a trade or business. It is believed that income from all publicly traded partnerships should be treated similarly to income from such investments for purposes of the passive loss rule.

Thus, the amendment provides that net income from an interest in any publicly traded partnership is not treated as passive income that can be offset by passive losses. Rather, like dividend income and other portfolio income, income from publicly traded partner-

ship interests is not allowed to be offset by losses (or credits) from passive activities. Losses (and credits) from interests in such partnerships are suspended at the partner level and allowed upon a disposition of the interest in the partnership.

Explanation of Provision

General rules

Under the amendment, net income from publicly traded partnerships is not treated as passive income for purposes of the passive loss rule. Each partner in a publicly traded partnership treats loss (if any) from the partnership as separate from income and loss from any other publicly traded partnership, and also as separate from any income or loss from passive activities. Net income from publicly traded partnerships is treated as portfolio income under the passive loss rule.

Net losses and credits attributable to the interest in the publicly traded partnership are not allowed against the partner's other income, but rather are suspended and carried forward. Such net losses can be applied against net income from the partnership in the next year (or the next succeeding year in which the holder of an interest in the partnership has net income from the partnership). Upon a complete disposition (within the meaning of the passive loss rule) of the partner's entire interest in the publicly traded partnership, any remaining suspended losses are allowed.

In general, income and loss items attributable to an interest in a publicly traded partnership can offset each other. Thus, for example, assume that a holder of an interest in a publicly traded partnership has a net loss from the partnership in one year of $2,000, and net income from the partnership in the next year of $1,500. $1,500 of the loss from the first year may be applied against the $1,500 income in the second year. The remaining $500 loss continues to be suspended at the partner level, and may be carried forward to future years to offset net income from the partnership. Similarly, a partner's share of credits from the partnership may be applied only to offset the partner's income tax liability attributable to the partnership interest. It is intended, however, that a partner be entitled to the $25,000 allowance with respect to credits from the partnership as under present law. The election to adjust basis in the event of a disallowed credit upon a complete disposition is intended to apply, in the case of a complete disposition of an interest in a publicly traded partnership.

In the case of publicly traded partnerships with income that is treated as portfolio income (under the passive loss rule as generally applicable) and losses from business activities, the losses may not be applied against the portfolio income. Thus, under the amendment, partners' shares of the loss may not be applied against their shares of that portfolio income. Thus, partners in publicly traded partnerships cannot offset losses from partnership activities against portfolio income within the partnership that could not be offset against portfolio income derived outside the publicly traded partnership.

In determining which losses from the partnership interest are suspended and carried forward under the provision, the general

rules normally applicable in determining which losses are suspended under the passive loss rule are applicable. Generally, the amount of the suspended losses is determined on a pro rata basis.

For purposes of this rule, partners in publicly traded partnerships treat their interests in each such partnership as separately subject to the loss (and credit) limitation and disposition rules of the passive loss rule. Thus, under this rule, no net losses or credits attributable to an interest in a publicly traded partnership are allowed against income other than income from that partnership (except as otherwise provided under the passive loss rule, for example, upon a complete disposition of the partner's interest in the partnership).

The rules applicable to transfers by reason of death and to gifts are also intended to apply, in the case of transfers of interests in publicly traded partnerships. This is consonant with applying the loss and credit limitations and the disposition rules of the passive loss rule separately at the partner level to partners' items from publicly traded partnerships.

The intended overall result is that net losses and credits of a partner from each publicly traded partnership be suspended at the partner level, carried forward (not back) and netted against income, other than the partnership's portfolio income, from (or tax liability attributable to) that publicly traded partnership, and that suspended losses are allowed upon a complete disposition of the partner's interest in the partnership.

Publicly traded partnerships

Publicly traded partnerships are defined for purposes of the provision as partnerships whose interests are (1) traded on an established securities market, or (2) readily tradeable in a secondary market (or the substantial equivalent thereof).

For this purpose, an established securities market includes any national securities exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions, and any local exchange. It also includes any over the counter market. An over the counter market is characterized by an interdealer quotation system which regularly disseminates quotations of obligations by identified brokers or dealers, by electronic means or otherwise.

An interest is treated as readily tradeable on a secondary market (or the substantial equivalent thereof) if the interest is regularly quoted by brokers or dealers making a market in the interest. (See Treas. Reg. section 1.453-3(d)(3).) Thus, for example, an interest is readily tradeable in a secondary market where the interest is traded on a market essentially equivalent to an over the counter market, or where the holder has a readily available, regular and ongoing opportunity to sell or exchange his interest.

A partner's ability to trade the interest, without more, will not cause the interest to be treated as readily tradeable, nor will occasional sales of interests in the partnership, the terms of which are not widely publicized or widely available, indicate the existence of a secondary market.

The existence of a buy-sell agreement among the partners, without more, will not cause a partnership to be treated as publicly

traded. Nor will the occasional and irregular repurchase or redemption by the partnership, or acquisition by the general partner, of interests in the partnership, cause the partnership to be considered as publicly traded under the provision. A regular plan of redemptions or repurchases, or similar acquisitions of interests in the partnership such that holders of interests have readily available opportunities to dispose of their interests, that is essentially equivalent to a secondary market, indicates that the interests are readily tradeable on what is the substantial equivalent of a secondary market.

In general, a provision for the discretion of the general partner or the partnership to refuse consent to transfer of an interest in the partnership (or of rights to income or other attributes of an interest in the partnership) does not, without more, prevent a partnership from being considered publicly traded. For example, the discretion of the general partner to refuse consent to a transfer if the transfer would cause a termination of the partnership for Federal income tax purposes does not cause the partnership to be treated as not publicly traded. Similarly, if the general partner must consent to any transfer of an interest in the partnership, but the assignment of rights to income (or other attributes) of the partnership is not so limited, the consent requirement does not cause the partnership to be considered as not publicly traded.

Effective Date

The provision is effective as if included in the amendments made by section 501 of the Tax Reform Act of 1986. Thus, the provision is effective for taxable years beginning after December 31, 1986.

2. Study of Tax Treatment of Publicly Traded Partnerships (sec. 4531(b) of the bill)

Present Law

Present law provides that a partnership is not subject to tax at the partnership level, but rather, income and loss of the partnership is subject to tax at the partner's level. A partner's share of partnership income is generally determined without regard to whether he receives any corresponding cash distributions. Thus, under present law, partnerships generally are treated as conduits for tax purposes.

Reasons for Change

This amendment changes the tax treatment of certain publicly traded partnerships, based on concerns related to preserving the effectiveness of the passive loss rule to curb tax shelters, achieving fair and equitable tax rules, and improving administrability of the tax law. Therefore it is appropriate to monitor and observe the changes made, in order to ascertain whether they have been effective and whether further changes are necessary.

Explanation of Provision

The amendment provides that the Secretary of the Treasury or his delegate shall conduct a study of compliance and administrative issues relating to the tax treatment of publicly traded partnerships and other large partnerships.

Effective Date

The Secretary is required to submit a report on the study, with such recommendations as the Secretary deems appropriate, to the House Committee on Ways and Means and the Senate Committee on Finance no later than January 1, 1989.

E. CHILD AND DEPENDENT CARE CREDIT

Deny Eligibility of Overnight Camp Expenses for Credit

(Sec. 4541 of the bill and sec. 21 of the Code)

Present Law

An income tax credit is provided equal to up to 30 percent of certain employment-related child and dependent care expenses (sec. 21). For example, costs incurred by the taxpayer for a day care center or nursery school, a housekeeper or other home care, and summer camps (including overnight camps) are eligible for the credit if incurred to enable the taxpayer to work.

The amount of qualified expenses eligible for the credit is limited to $2,400 ($4,800 for the care of two or more individuals). The 30 percent credit rate is reduced by one percentage point for each $2,000 (or portion thereof) of adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI exceeding $28,000.

Reasons for Change

It was concluded that a taxpayer's expenses for sending a child or other dependent to an overnight camp are not sufficiently related to the taxpayer's employment to justify providing a tax credit for such costs, as contrasted to the costs of day care. Overnight camp expenses are a personal consumption expenditure that is not a necessary cost of being able to go to work.

Explanation of Provision

Under the provision, costs incurred by a taxpayer to send a child or other dependent to an overnight camp are ineligible for the child and dependent care credit.

Effective Date

The provision is effective for expenses paid in taxable years beginning on or after January 1, 1988.

F. PENSION PROVISIONS

1. Modify Full Funding Limitation (sec. 4551 of the bill and sec. 412 of the Code)

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a qualified defined benefit pension plan up to the full funding limitation (sec. 404). The full funding limitation generally is defined as the excess, if any, of (1) the accrued liability (including normal cost) under the plan, over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the value of the plan's assets determined under section 412(c)(2) (sec. 412(c)(7)). Generally, the accrued liability is based on projected benefits, which, unlike accrued benefits, are the benefits that are projected to be earned by normal retirement age, rather than the benefit accrued as of the close of the current year.

If a defined benefit plan is terminated, the employer's liability to plan participants does not exceed the plan's termination liability (generally the liability for benefits determined as of the date of the plan termination). However, contributions to a plan with assets significantly in excess of termination liability may be deductible because the full funding limitation is determined on the basis of projected benefits.

Reasons for Change

Defined benefit pension plans should be funded in such a manner as to provide benefit security for participants. An employer should not be entitled, however, to make excessive contributions to a defined benefit pension plan to fund liabilities that it has not yet incurred. Such use of a defined benefit plan is equivalent to a tax-free savings account for future liabilities and is inconsistent generally with the treatment of unaccrued liabilities under the Code.

An overall cap on an employer's deductions for plan contributions is appropriate in the case of overfunded plans. A proper balance between the competing concerns described above is achieved by limiting deductible contributions to a defined benefit pension plan to the extent that the contributions cause plan assets to exceed 150 percent of current liabilities, (i.e., generally accrued liabilities).

Explanation of Provision

Under the amendment, the full funding limitation generally is defined to mean the excess, if any, of (1) the lesser of (a) the accrued liability (including normal cost) under the plan, or (b) 150 percent of current liabilities (as defined for purposes of the funding

rules in this amendment, except that pre-participation years of service are taken into account in all cases), over (2) the lesser of (a) the fair market value of the plan's assets, or (b) the value of the plan's assets determined under section 412(c)(2).

The amendment does not modify the definition of accrued liability in section 412(c)(7). Also, the requirement of section 412(c)(6)(B) that all amortizable amounts be considered fully amortized is applied without regard to the change in the full funding limitation (adding the 150 percent of current liability limitation).

It is further intended that the full funding limitation (as well as the other limitations on deductions for plan contributions) may not be avoided by the creation of multiple plans with coordination of benefits between the plans. The Secretary is to prescribe rules consistent with this intent.

Effective Date

This provision is effective for years beginning after December 31, 1987.

2. Minimum Funding Standard and Deductions

a. Additional funding requirements (sec. 4552 of the bill)

Present Law

In general

Under present law, certain defined benefit pension plans are required to meet a minimum funding standard for each plan year. The minimum funding standards require that an employer contribute an annual amount sufficient to fund a portion of participants' projected benefits determined in accordance with one of several prescribed funding methods, using actuarial assumptions that are reasonable in the aggregate.

Generally, a funding method calculates the cost of benefits under the plan in 2 components: (1) normal cost, which represents the cost of benefits allocated to the current year under the plan's funding method, and (2) a portion of the plan's accrued liabilities (i.e., all costs other than normal cost). The costs in (2) include costs with respect to past service liability (e.g., the cost of retroactive benefit increases), experience losses, and changes in actuarial assumptions. The amounts in (2) above are amortized over a period of years depending on the nature of the cost. Experience gains and gains from changes in actuarial assumptions are taken into account generally by offsetting a portion of the gains against the amounts determined under (1) and (2) above for the year. Losses increase such amounts.

Each defined benefit pension plan is required to maintain a special bookkeeping account called a "funding standard account". The account is charged with the costs described above and the amount necessary to amortize waived contributions (see below), and credited with the gains described above, the amount of waived contributions for the year, and contributions for the plan year. If, as of the close of a plan year, the account reflects credits equal to or in excess of charges, the plan is treated as meeting the minimum funding standard for the year. Thus, as a general rule, the mini-

mum contribution for a plan year is determined as the amount by which the charges to the account would exceed credits to the account if no contribution were made to the plan.

Currently, some employers maintain "floor-offset" arrangements, which are a combination defined contribution plan and defined benefit plan. Under such an arrangement, a participant's benefits under the defined benefit plan (the floor plan) are offset by the participant's benefits under the defined contribution plan (the offset plan). The IRS has ruled that floor-offset arrangements may meet the qualification requirements of the Code if certain requirements are satisfied.

Past service liabilities

Past service liability existing before the effective date of the minimum funding standards (generally, 1976) is amortized over a period of 40 years. All other past service liability is amortized over a period of 30 years.

Experience gains and losses

Experience losses arise when a plan's experience is less favorable than anticipated under the plan's assumptions (e.g., interest, mortality, morbidity, and employee turnover). Similarly, experience gains arise when a plan's experience is more favorable than anticipated. Experience gains and losses are amortized over 15 years.

Gains and losses from changes in assumptions

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the liability of a plan is less than the liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the liability, the plan has a loss from changes in actuarial assumptions. The gain or loss for a year from changes in actuarial assumptions is amortized over a period of 30 plan years.

Switchback liability

Certain plans may elect to use an alternative minimum funding standard account for any year in lieu of determining contributions under the rules described above. Specified annual charges and credits apply with respect to the alternative account. The minimum funding standard is considered satisfied for a year if a contribution meeting the requirements of the alternative account is made, even if a greater contribution would be required under the normal funding rules.

If the plan switches back from the alternative account to the regular method of determining contributions, the excess, if any, of charges over credits at the time of the change ("the switchback liability") must be amortized over a period of 5 plan years.

Contingent benefits

Under present law, benefits contingent on events such as the shutdown of a facility are funded in the same manner as other benefits. Thus, the plan assumptions may include a probability that the shutdown or other contingency will occur. If too low a likeli-

hood of the contingency occurring is assumed, then an experience loss occurs when the event occurs.

Shutdown and similar contingent benefits are guaranteed by the Pension Benefit Guaranty Corporation (PBGC) in accordance with the generally applicable rules regarding such guarantees (e.g., the limit on the dollar amount and type of benefit guaranteed) (see discussion below). To the extent the benefits are guaranteed, the guarantee phases in over time after the plan or plan amendment providing for the benefit is adopted (or the effective date of the plan or amendment, if later).

Valuation of assets

Under present law, the value of plan assets is to be determined in accordance with any reasonable actuarial method of valuation that takes into account fair market value and that is permitted under Treasury regulations. The regulations permit plan assets to be valued on the basis of the average value over a period not exceeding the 5 most recent plan years. Regardless of the valuation method used, the method must result in a value that is between 80 percent and 120 percent of fair market value or between 85 percent and 115 percent of average value as defined in the regulations (Treas. reg. sec. 1.412(c)(2)-1(b)(6)).

Factors contributing to underfunding of defined benefit plans

A plan is considered to be underfunded if, upon termination, it lacks sufficient assets to discharge its liabilities. One reason underfunding may arise is that, despite the minimum funding standard, the plan may terminate before the time necessary for full amortization of its liabilities has expired. This is particularly true with respect to plans that base benefits solely on service, rather than on service and salary, and that provide regular benefit increases with respect to all years of service.

For example, assume that, at the time a plan was adopted, it provided benefits measured (in part) by service performed before the plan was adopted. The liability for those benefits (past service liability) is amortized over a period of 30 years. If the plan terminates before the end of the 30-year period, then the plan will be underfunded unless favorable investment experience, gains due to favorable mortality experience or other experience gains are sufficient to offset the unfunded liability arising from the past service benefit.

Underfunding may also be attributable to unamortized losses arising from investment experience or other experience (e.g., mortality, morbidity, employee turnover) that is less favorable than anticipated. An example of significant experience losses creating underfunding is the substantial increase in plan liabilities that is triggered by a plant closing or similar sudden workforce contraction that has not been fully anticipated in funding the plan. In some cases, a plan is underfunded at termination because the employer obtained a waiver of the funding standard and the plan was terminated before the waived funding deficiency was fully amortized.

Reasons for Change

As of September 30, 1985, the PBGC reported a deficit of approximately $1.3 billion. As of September 30, 1986, the PBGC's deficit nearly tripled over the prior year, reaching $3.8 billion (approximately $2 billion of which is attributable to the termination of plans maintained by LTV Corporation). The substantial increase in the deficit of the PBGC is generally attributed to the termination of certain steel industry pension plans with insufficient assets to provide guaranteed benefits.

The PBGC's deficit has not affected its immediate ability to pay pension benefits to retired participants in terminated plans. However, PBGC officials estimate that projected increases in the PBGC's deficit could result in insufficient assets to pay annual costs in approximately 15 years.

The General Accounting Office issued a report on March 19, 1987 (the "GAO Report") [6] stating that, during the years 1983-85, 70 percent of the claims against the PBGC for termination of underfunded plans resulted because the present-law funding standards do not require sufficient contributions to fund increased unfunded liabilities arising in part from numerous benefit increases within 5 years of plan termination.

It is believed that the present-law funding requirements expose plan participants and the PBGC to excessive risk. Under present law, the funded status of a plan may deteriorate even if the minimum funding requirements are fully satisfied. Thus, it is concluded that the present-law rules, which provide long-term financing of increases in unfunded liabilities under a pension plan, create an incentive for employers to provide benefit increases that might otherwise not be affordable.

Accordingly, more rapid funding requirements would more appropriately limit the ability of employers to delay or avoid funding obligations. An employer should not have the opportunity to make pension promises that exceed its financial capacity to meet its promises. In order to reduce the financial risk to plan participants and the PBGC, the amendment requires certain plans to be funded more rapidly depending on the funded status of the plan.

It is believed that certain types of contingent benefits create special funding problems. Benefits contingent on relatively unpredictable events, such as a plant shutdown, typically are not adequately funded before the event occurs. Thus, upon the occurrence of the contingency, a tremendous increase in plan underfunding may occur, and the employer often is not financially able to fund such benefits at that time. In some cases, the liability for the benefits may be shifted to the PBGC. It is believed that it is appropriate to provide special funding rules with respect to certain contingent benefits.

---

[6] U.S. General Accounting Office, *Pension Plans: Government Insurance Program Threatened By Its Growing Deficit* (GAO/HRD-87-42).

Explanation of Provisions

In general

The amendment retains the present-law funding standards under section 412 of the Code, with certain modifications. In addition, with respect to an underfunded plan, the minimum required contribution is, in general terms, the greater of (1) the amount determined under section 412 (with the modifications made by the amendment), or (2) the sum of (i) normal cost, (ii) the amount necessary to amortize experience gains and losses and gains and losses resulting from changes in actuarial assumptions over 5 years, and (iii) the deficit reduction contribution. In addition, a special funding rule applies with respect to benefits that are contingent on unpredictable events.

More specifically, the amendment provides that, for an underfunded plan, the amount otherwise required to be charged to the funding standard account for a plan year otherwise is increased by (1) the excess of (i) the deficit reduction contribution over (ii) certain charges to the funding standard account reduced by certain credits to such account, plus (2) the unpredictable contingent event amount (if any) for the plan year. The charges taken into account under the preceding sentence include (i) the amount necessary to amortize past service liability, (ii) the amount necessary to amortize each waived funding deficiency, and (iii) the amount necessary to amortize certain amounts credited in the case of an employer previously using the alternative minimum funding standard account (the switchback liability). The credits taken into account include the amounts necessary to amortize decreases in past service liability.

As under present law, contributions in excess of the minimum required contribution will create funding credit balances that may be used to offset the required minimum contribution. In addition, credit balances in existence on the effective date may be used to offset required minimum contributions. The amendment does not affect the ability of an employer to maintain a floor-offset arrangement.

Deficit reduction contribution

Under the amendment, the deficit reduction contribution is the sum of (1) the unfunded old liability amount, and (2) the unfunded new liability amount. Calculation of these amounts is based upon the plan's "current liability".

Current liability

Under the amendment, the term "current liability" means all liabilities to employees and their beneficiaries under the plan (as determined under sec. 401(a)(2)). However, the value of any "unpredictable contingent event benefit" is not taken into account in determining current liability until the event on which the benefit is contingent occurs. An "unpredictable contingent event benefit" is any benefit contingent on an event other than (1) age, service, compensation, death, or disability, or (2) an event which is reasonably and reliably predictable as determined by the Secretary.

80-012 O - 87 - 3

It is not intended that an event will be considered reliably and reasonably predictable solely because an actuarial probability of the event occurring may be determined. It is further intended that the Secretary of the Treasury will prescribe rules defining events that can and cannot be reasonably and reliably predicted and will revise these rules as new benefits are developed.

Unpredictable contingent event benefits are intended to include benefits that depend on contingencies that, like facility shutdowns or reductions or contractions in workforce, are not reliably and reasonably predictable. Such contingencies are not limited to events that are similar to shutdowns or reductions in force. For example, a benefit dependent on the profits of the employer or the value of employer stock dropping below a certain level would be considered a benefit contingent on an event that is not reasonably and reliably predictable (unless the contingency is illusory).

If an employer provides an early retirement window benefit under which employees who have satisfied certain age or service requirements or both are offered a limited period of time during which they may elect to retire, such a window benefit is generally considered to be contingent on an event that can be reasonably and reliably predicted. The Secretary of the Treasury may, in appropriate circumstances, treat such window benefits as benefits which are contingent on an event that cannot be reasonably and reliably predicted.

It is intended that a benefit contingent on marital status, such as a qualified joint and survivor annuity, is generally to be considered a benefit that is contingent on an event that can be reasonably and reliably predicted.

It is intended that the Secretary of the Treasury may prescribe rules to prevent employers from avoiding the new minimum funding rules by characterizing contingencies as not reasonably and reliably predictable. For purposes of the definition of current liability, a benefit is generally not to be considered contingent on an event which is not reasonably and reliably predictable if there is substantial certainty that the event on which the benefit depends will occur.

An early retirement subsidy, social security supplement, survivor subsidy or similar benefit in addition to the basic retirement benefit under a plan that is payable only on the satisfaction of certain eligibility conditions, (e.g., age and/or years of service eligibility conditions) is included in current liability to the extent that the employee has earned the subsidy, supplement, or similar benefit.

For example, assume that a plan provides that an employee is entitled to a basic retirement benefit commencing at age 65 of 1 percent of final average pay times years of service and that, if the employee retires at age 55 with at least 25 years of service, the employee's retirement benefit will not be actuarially reduced for early commencement (i.e., this is an early retirement subsidy). For purposes of calculating the current liability for such plan for a year, an employee age 50 with 20 years of service has a total retirement benefit (i.e., normal retirement benefit plus early retirement subsidy) of 80 percent of the unreduced age 55 benefit (based on final average pay at age 50). That is, there is no actuarial reduction for commencement before age 65. The same analysis applies in deter-

mining the extent to which a social security supplement, survivor subsidy, or similar benefit has been earned under the plan.

Current liability is generally determined in accordance with plan assumptions. Thus, in the example described above, because not all employees who have earned a right to some portion of the early retirement benefit will ultimately satisfy the eligibility conditions for the subsidy (e.g., not all such employees will remain with the employer until age 55), a plan is to calculate its current liability for the year by using reasonable turnover and mortality factors.

The amendment provides a special limitation on the interest rate used for purposes of calculating current liability. Under the amendment, the interest rate is the rate used for calculating costs under the plan. If such rate is not within the permissible range, then the plan is required to establish a new interest rate that is within the permissible range. The permissible range is defined as a rate of interest that is not more than 20 percent above or below the average mid-term applicable Federal rate (AFR) for the 3-year period ending on the last day before the beginning of the plan year for which the interest rate is being used (or, if shorter, the period that the AFR has been computed). The average is determined by averaging the rate in effect for each month during the applicable 3-year period. The Secretary may prescribe one or more indices in lieu of the average mid-term AFR to be used in determining the permissible range.

The amendment provides that certain service may be disregarded at the employer's election in calculating the plan's current liability. In the case of certain participants, the applicable percentage of the years of service before the individual became a participant are taken into account in determining current liability. The applicable percentage is (1) 0, if the individual has 5 or less years of participation, (2) 20, if the individual has 6 years of participation, (3) 40, if the individual has 7 years of participation, (4) 60, if the individual has 8 years of participation, (5) 80, if the individual has 9 years of participation, and (6) 100 if the individual has 10 or more year of participation. Partial years of participation are rounded to the nearest whole year.

The rule disregarding pre-participation service is available with respect to any participant who, at the time of becoming a participant, has not accrued any other benefits under any defined benefit pension plan (whether or not terminated) of the employer or the employer's controlled group, and has years of service before such time in excess of the years of service required for eligibility to participate in the plan. The rule applies only with respect to new participants in years beginning after December 31, 1987.

The amendment provides that unfunded current liability means, with respect to any plan year, the excess of (1) the current liability under the plan over (2) the value of the plan's assets reduced by any credit balance in the funding standard account. The funded current liability percentage of a plan for a plan year is the percentage that (1) the value of the plan's assets reduced by any credit balance in the funding standard account is of (2) the current liability under the plan.

Unfunded old liability amount

The unfunded old liability amount is, in general, the amount necessary to amortize the unfunded old liability under the plan in equal annual installments (until fully amortized) over a fixed period of 15 plan years (beginning with the first plan year beginning after December 31, 1988). The "unfunded old liability" with respect to a plan is the unfunded current liability of the plan as of the beginning of the first plan year beginning after December 31, 1987, determined without regard to any plan amendment adopted after October 16, 1987, that increases plan liabilities (other than amendments adopted pursuant to collective bargaining agreements described in the following paragraph).

Under a special rule applicable to collectively bargained plans, increases in liabilities pursuant to a collective bargaining agreement ratified before October 17, 1987, are also amortized over 15 years. Thus, under the amendment, the unfunded old liability amount with respect to a collectively bargained plan is increased by the amount necessary to amortize the unfunded existing benefit increase liabilities in equal annual installments over a fixed period of 15 plan years, beginning with the plan year in which the increase in liabilities occurs pursuant to the bargaining agreement (or, if later, the first plan year beginning after December 31, 1988). For purposes of this rule, the unfunded existing benefit increase liability means the unfunded current liability determined by taking into account only (1) liabilities attributable to the increase in liabilities pursuant to the agreement, and (2) the value of assets in excess of current liability (determined without regard to the liabilities described in (1)).

The employer may elect to amortize unfunded existing benefit increase liability under an alternative rule instead of the rule described above. Under the alternative rule, the increases in liabilities under the collective bargaining agreement would be calculated as of the beginning of the first plan year beginning after December 31, 1987. This amount would be included in calculating the initial unfunded old liability and, together with any other unfunded old liability, would be amortized over 15 years (beginning with the first plan year beginning after December 31, 1988).

For purposes of determining the unfunded existing benefit increase liability, any extension, amendment, or other modification of a bargaining agreement after October 16, 1987, is not taken into account. In general, the unfunded existing benefit increase liability only includes increases in liability pursuant to the bargaining agreement and therefore does not include liability increases with respect to individuals covered by the plan who are not subject to the collective bargaining agreement. However, if more than 75 percent of the employees covered by the plan on October 16, 1987, are subject to the collective bargaining agreement, then the unfunded existing benefit increase liability includes the liability with respect to all employees in the plan whose benefits are determined directly or indirectly by reference to the terms of the bargaining agreement, whether or not such employees are subject to the agreement. Separate plans may not be treated as a single plan for purposes of this rule, even if the benefits under the plans are coordinated.

For example, assume a benefit increase under a collective bargaining agreement ratified before October 17, 1987, takes effect on January 1, 1990, and that the liability due to the benefit increase is $10x. The current liability of the plan determined without regard to the benefit increase is $100x, and the value of plan assets is $105x. The plan year is the calendar year. The unfunded existing benefit increase liability is $5x. This amount will be amortized over 15 years, beginning in 1990.

Alternatively, instead of amortizing the benefit increase as described above, the employer could elect to add the liability due to the increase (calculated as of January 1, 1988) to the unfunded old liability (determined without regard to the benefit increase) and amortize the entire amount over 15 years beginning in 1989.

Unfunded new liability amount

The unfunded new liability amount for a plan year is the applicable percentage of the plan's "unfunded new liability." "Unfunded new liability" means the unfunded current liability of the plan for the plan year, determined without regard to (1) the unamortized portion of the unfunded old liability and (2) the liability with respect to any unpredictable contingent event benefits, without regard to whether or not the event has occurred. Thus, in calculating the unfunded new liability, all unpredictable contingent event benefits are disregarded, even if the event on which that benefit is contingent has occurred.

If the funded current liability percentage is less than 35 percent, then the applicable percentage is 30 percent. The applicable percentage decreases by .25 of one percentage point for each 1 percentage point by which the plan's funded current liability percentage exceeds 35 percent. For example, if the funded current liability percentage is 55 percent, then the applicable percentage is 25 percent, and the unfunded new liability amount for the plan year is 25 percent of the unfunded new liability. Similarly, if the funded current liability percentage is 80, then the applicable percentage is 18.75 and the unfunded new liability amount for the plan year is 18.75 percent of the unfunded new liability.

Unpredictable contingent event benefits

If the event on which an unpredictable contingent event benefit is contingent occurs during the plan year and the assets of the plan are less than current liability (calculated after the event has occurred), then an additional funding contribution (over and above the minimum funding contribution otherwise due) is required. The amount of the required additional contribution is generally equal to the greater of (1) the amount of unpredictable contingent event benefits paid during the plan year (regardless of the form in which paid), including (except as provided by the Secretary of the Treasury) any payment for the purchase of an annuity contract with respect to a participant with respect to such benefits, and (2) the amount that would be determined for the year if the unpredictable contingent event benefit liabilities were amortized in equal annual installments over 5 years, beginning with the plan year in which the event occurs. For the year in which the event occurs, an amount equal to 150 percent of the amount determined under (1)

above may, at the employer's election, be treated as the unpredictable contingent benefit amount. In no case, however, will the unpredictable contingent event amount exceed the unfunded current liability (including the liability due to the contingent event benefit) of the plan.

If the event on which an unpredictable contingent event benefit is contingent occurs during the plan year and the assets of the plan equal or exceed current liability (calculated after the event has occurred), then the employer may continue to fund the plan's unpredictable contingent event benefits as under present law (i.e., generally as an experience loss), subject to the application of the special rule if the plan's funding falls below current liability.

Adjustments

The Secretary of the Treasury is to prescribe appropriate adjustments in the unpredictable contingent event amount, the old liability amount, the new liability amount, and the other charges and credits under section 412 as are necessary to avoid inappropriate duplication or omission of any factors in the determination of such amounts, charges and credits (for example, adjustments reflecting asset appreciation or depreciation).

It is also intended that the Secretary will provide special rules for multiple-employer plans where appropriate.

Small plan exception

The new funding rules for plans with assets less than current liability do not apply to a plan with no more than 100 participants on any day in the preceding plan year. In the case of a plan with more than 100 but no more than 150 participants during the preceding year, the amount of the additional contribution is determined by multiplying the otherwise required additional contribution by 2 percent for each participant in excess of 100. For purposes of this rule, all defined benefit plans (including multiemployer plans) of the employer and the employer's controlled group are treated as a single plan. Controlled group is defined as in section 414(b), (c), (m) and (o). With respect to a multiemployer plan, only employees of the employer (or a controlled group member) are taken into account.

Valuation regulations

The amendment provides that, effective with respect to plan years beginning after December 31, 1987, the portions of the regulations permitting asset valuations to be based on a range between 85 percent and 115 percent of average value are to have no force and effect. In addition, the amendment provides that the Secretary of the Treasury is to amend the regulations to carry out the intent of this provision.

Effective Dates

In general, the changes in the minimum funding requirements for defined benefit pension plans apply with respect to plan years beginning after December 31, 1988.

Contingent event benefits with respect to which the event has occurred before October 17, 1987, are not subject to the new funding rule for such benefits. If the event has not occurred on or before October 16, 1987, such benefits are subject to the new funding rules for such benefits. If the event occurs after October 16, 1987, and before the first day of the first plan year beginning after December 31, 1988, funding under the new rule begins in such first plan year. Of course, for the first plan year beginning after December 31, 1987, contingent event benefits are subject to the new rules regarding gains and losses.

With respect to provisions that cross reference the definition of "current liability," the definition is effective at the time the provision cross referencing it is effective.

b. Time for making contributions (sec. 4553 of the bill)

Present Law

Under present law, an employer is treated as making a contribution that satisfies its minimum funding requirement for a plan year if the contribution is made within 8-1/2 months after the close of the plan year. Of that 8-1/2-month grace period for making plan contributions, 6 months were provided under Treasury regulations.

Reasons for Change

In light of the GAO report, it is believed that it is not appropriate to permit employers to make no contributions until 8-1/2 months following the end of the plan year. The GAO report found that a significant amount of claims against the PBGC occurred when plan contributions for a year were not made because the payment deadline expired after the date of plan termination.

Further, it is believed that requiring quarterly plan contributions could provide an early warning to the PBGC, the IRS, and to plan participants of possible employer difficulty in meeting its funding obligations. Such an approach is consistent with other tax laws, such as those requiring withholding taxes and estimated tax payments to be made on a quarterly basis. Because the amendment requires that a significant portion of the year's contribution be made in installments during the plan year, it is believed that that it is not necessary to accelerate the 8-1/2 month period for making the final plan contribution.

In addition, there is concern that, under present law, employees do not receive adequate information relating to the funded status of a plan maintained by the employer. As a result, employees may make retirement planning decisions without knowledge of the risk that they will not receive their promised benefits under the employer-maintained plan. Accordingly, it is believed that employees should be aware of whether or not the employer is making required contributions to the plan so that each employee may assess the risk that the employer's plan will not have sufficient assets to pay benefits when due.

In order to ensure that contributions are actually paid to the plan, it is also believed that it is appropriate to provide for a lien in favor of the plan if contributions are missed.

Explanation of Provisions

Quarterly payments of estimated required contribution

Under the amendment, 4 installment payments of minimum funding contributions are required for each plan year. The due dates of these 4 required installments are, in the case of a calendar year plan year, April 15, July 15, October 15, and January 15 of the following year. The amount of each required installment is 25 percent of the required annual payment.

The amendment defines the required annual payment to be the lesser of (1) 90 percent of the amount the employer is required to contribute for the plan year under the minimum funding requirements (other than the unpredictable contingent event amount) or (2) 100 percent of the amount the employer was required to contribute for the preceding plan year (other than the unpredictable contingent event amount) with respect to the plan and any predecessor plans. The second rule does not apply if the preceding plan year was less than 12 months. The unpredictable contingent event amount is required to be contributed in addition to the installment contributions otherwise due. Thus, for example, if the unpredictable contingent event amount for a quarter is equal to the amount of payments of unpredictable contingent event benefits, such amount is required to be contributed at the same time and in addition to the otherwise required next quarterly installment.

In the case of a plan year that is not a calendar year, the due dates of the required installments are (1) the 15th day of the 4th month, (2) the 15th day of the 7th month, and (3) the 15th day of the 10th month following the beginning of the plan year, and (4) the 15th day of the 1st month following the beginning of the following plan year. Under the amendment, the due dates of required installments in the case of a short plan year are to be determined under Treasury regulations.

If a required installment is not paid to the plan by the due date for the installment the funding standard account is charged with interest on the amount of the underpayment for the period of the underpayment. The amount of the underpayment is determined by subtracting the installment payments made on or before the due date of the installment from the required installment.

The period of the underpayment is the period from the due date of the installment to the earlier of (1) the contribution due date for the plan year (i.e., 8-1/2 months following the end of the plan year), or (2) with respect to any portion of an underpayment, the date on which the portion is contributed to the plan. Contributions are credited first to the underpayments arising first.

The rate of interest is the greater of 175 percent of the Federal mid-term rate (AFR) or the rate of interest used under the plan in determining costs.

Notice of failure to meet minimum funding standards

The amendment requires that the employer is to notify participants and beneficiaries if the employer fails to make a required installment or fails to make the final contribution (i.e., the contribution required by 8-1/2 months following the end of the plan year). It is expected that the Secretary will prescribe special notice rules

in the case of multiple employer plans targetting the notice to participants and beneficiaries with respect to the employer failing to make the required contribution.

Imposition of lien

If the employer fails to make a required contribution (including a required installment payment) when due, a lien arises in favor of the plan in the amount of the missed contribution (including interest). The lien is on all property and rights to property, whether real or personal, belonging to the contributing sponsor and members of the controlled group of the contributing sponsor. The lien generally arises 30 days after the due date of the contribution, and continues until the payment of such contribution (including interest). However, if a timely request for a funding waiver is made with respect to the contribution, then the lien does not arise until the day after the waiver is denied. No lien arises if the waiver is granted. The employer is required to notify the PBGC of any failure to make a required contribution within 10 days after the due date of the contribution.

If the employer fails to make successive contributions, the lien previously in existence under this provision does not terminate. Rather, the provision operates with respect to each successive missed contribution.

The lien may be perfected and enforced only by the PBGC or, at the direction of the PBGC, by the contributing sponsor or any member of the controlled group of the contributing sponsor. Rules similar to the rules in section 4068(c), (d), and (e) of ERISA apply with respect to the lien and the amount on which the lien is based. A perfected lien is treated as a Federal tax lien, and an unperfected lien is treated as a Federal tax claim.

Effective Dates

The provisions are effective for plan years beginning after December 31, 1987. Under a transition rule, the amount of each required installment payment (other than payments of the unpredictable contingent event amount) is (1) 5 percent for plan years beginning in 1988, (2) 10 percent for plan years beginning in 1989, (3) 15 percent for plan years beginning in 1990, and (4) 20 percent for plan years beginning in 1991.

c. Liability of members of controlled group for taxes on failure to meet minimum funding standards (sec. 4554 of the bill)

Present Law

If, as of the close of any plan year, the minimum required contribution has not been made and charges to the funding standard account exceed credits to the account, then the excess is referred to as an "accumulated funding deficiency." Unless a minimum funding waiver is obtained, an employer who is responsible for contributing to a plan with an accumulated funding deficiency is subject to a 5-percent nondeductible excise tax on the amount of the deficiency (Code sec. 4971). If the deficiency is not corrected within the

"taxable period," then an employer who is responsible for contributing to the plan is also subject to a nondeductible excise tax equal to 100 percent of the deficiency. The taxable period is the period beginning with the end of the plan year in which there is a deficiency and ending on the earlier of (1) the date of a mailing of a notice of deficiency with respect to the 5-percent tax or (2) the date on which the 5-percent tax is assessed by the Internal Revenue Service (IRS).

The excise taxes imposed for a failure to meet the funding requirements applicable to a plan are imposed only on an employer who is responsible for contributing to the particular plan in which the deficiency arises. Another taxpayer that is a member of the same controlled group of corporations or trades or businesses as the employer is not liable for a funding deficiency unless the other taxpayer is also responsible for contributing to that plan. Under proposed regulations, the entire controlled group would be liable for any excise taxes imposed for a failure by a member of the group to satisfy the minimum funding requirements.

Reasons for Change

It is believed that the present-law rules relating to the liability to make contributions to a pension plan enable an employer that is a member of a controlled group to avoid its liabilities when it is unable to make a required contribution even though other members of the employer's controlled group have sufficient assets to make the employer's required contribution. The failure to impose liability for the contributions on a controlled group basis increases the potential risk to plan participants and the PBGC.

In addition, in light of the GAO report, it is believed that increases in the taxes for failure to make contributions are needed to help ensure that contributions are made when due.

Explanation of Provision

Under the amendment, as under present law, the employer who maintains a pension plan is liable for any excise taxes imposed for a failure to meet the minimum funding standards (Code sec. 4971). In addition, if the employer is a member of a controlled group, each member of the employer's controlled group is jointly and severally liable for such excise taxes.

Under the amendment, a controlled group is any group of employers treated as a single employer under section 414(b), (c), (m), or (o).

The amendment also increases the amount of the first-tier excise tax from 5 percent to 10 percent.

Effective Date

The provision is effective for taxes imposed with respect to plan years beginning after December 31, 1987.

d. Funding waivers (sec. 4555 of the bill)

Present Law

Within limits, the IRS is permitted under present law to waive all or a portion of the contributions required under the minimum funding standard for a plan year. Generally, the IRS has required that a request for a waiver be submitted by the end of the plan year following the plan year for which the waiver is requested. A waiver may be granted if the employer (or employers) responsible for the contribution could not make the required contribution without substantial business hardship and failure to grant the waiver would be adverse to the interests of plan participants in the aggregate. The IRS generally takes the position that a waiver will not be granted unless the hardship is temporary and the employer demonstrates that recovery is likely. Under present law, an employer is required to notify each employee organization representing employees covered by the plan of an application for a funding waiver. No more than 5 waivers may be granted within any period of 15 consecutive plan years.

A waived contribution is a waived funding deficiency. Under the funding standard, the amount of a waived funding deficiency is amortized over a period of 15 plan years, beginning with the year following the year for which the waiver is granted. Each year, the funding standard account is charged with the amount amortized for that year unless the plan becomes fully funded. Interest on the waived amount is equal to the rate applicable to late payment of taxes (Code sec. 6621(b)). The IRS generally allows deductions for contributions made to amortize waived deficiencies more quickly than over 15 years. (See, e.g., Rev. Rul. 78-223, 1978-1 C.B. 125.)

Reasons for Change

It is believed that employers have used funding waivers in the past to minimize plan contributions during the period immediately preceding the termination of a plan. The GAO report found that 30 percent of the claims against the PBGC arising during the period 1983-1985 resulted from the failure of employers to make required plan contributions prior to plan termination. The GAO concluded that significant percentages of the large claims represented required contributions that were overdue or had been waived by the IRS.

Under present law, funding waivers are equivalent to an extension of credit from a plan to the employer that normally would be treated as a prohibited transaction. It is believed that such an extension of credit is not appropriate unless adequate safeguards apply to protect participants' benefits. Plan participants should not be required to finance the continuing operations of an employer by placing their retirement benefits at risk.

Further, it is believed that the integrity of the plan termination insurance program will be jeopardized if employers have the opportunity to avoid liability for their pension promises at the expense of other employers who moderated their promises or are more financially secure and remain in the defined benefit system.

Explanation of Provision

The amendment modifies the rules governing the availability of minimum funding waivers in several respects. Under the amendment, a waiver application is required to be filed no later than the due date for the contribution (including required installments). Thus, a waiver for a quarterly installment must be made by the due date for the installment.

The standards for obtaining a waiver are clarified by incorporating in the statute the present-law requirement that the employer seeking a waiver is required to establish that the financial hardship is temporary. The IRS is directed to apply the temporary hardship standard to prevent the granting of funding waivers to employers that will not recover sufficiently to make their waived contributions. Because all members of the controlled group of the employer maintaining the plan are liable for excise taxes under the minimum funding rules, the hardship determination is based, under the amendment, upon the circumstances of the entire controlled group, as well as the circumstances of the particular employer.

In order to make funding waivers more equivalent to commercial loans, the amendment provides that the interest rate on waived contributions for purposes of determining the amortization charge for waived amounts is increased from the interest rate applicable to the late payment of taxes to the greater of the plan's interest rate for funding purposes or 150 percent of the Federal mid-term rate (as in effect under sec. 1274 for the first month of the plan year). The interest rate based on the Federal mid-term rate is intended to be an administrable measure of a market interest rate for borrowing by a distressed company.

To protect plans against protracted periods of serious underfunding and serious deterioration of the funded status of the plan, the amendment provides that a funding waiver may not be granted with respect to a plan that has assets less than current liability. The determination of whether a plan has assets less than current liability is to be made at the beginning of the plan year or at such other time as determined by the Secretary.

In addition, the amendment reduces the number of waivers that may be granted with respect to any plan within a 15-year period from 5 to 3. A single waiver request may be made with respect to all quarterly contributions for a year and the final required contribution.

It is not intended that the amendment will affect the administrative practice of the IRS under which deductions are allowed for contributions that amortize waived funding deficiencies more rapidly than the required amortization.

Effective Dates

The provision relating to funding waivers is effective with respect to any application for a funding waiver submitted with respect to plan years beginning after December 31, 1987. With respect to the rule restricting the number of waivers in a 15-year period, waivers granted prior to the effective date are taken into account.

e. Amortization periods (sec. 4556(a) of the bill)

Present Law

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities. The actuarial assumptions are required to be reasonable in the aggregate. If, on the basis of these assumptions, the contributions made to the plan result in actual unfunded liabilities that are less than anticipated by the actuary, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss. For a single-employer plan, experience gains and losses for a year are amortized over a 15-year period.

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the liability of a plan is less than the liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the liability, the plan has a loss from changes in actuarial assumptions. The gain or loss for a year from changes in actuarial assumptions is amortized over a period of 30 plan years.

Reasons for Change

It is believed that the present-law amortization period for experience gains and losses delays unnecessarily the reconciliation of actual experience and actuarial assumptions. The present-law amortization period for experience losses contributes to underfunding and thereby undermines benefit security and increases the risk of loss to the PBGC. The present-law amortization period for experience gains similarly contributes to inappropriate overfunding because such gains are taken into account over a long period.

Similarly, it is believed that the present-law amortization period for gains and losses resulting from changes in actuarial assumptions delays unnecessarily the reconciliation of the old assumptions with the new assumptions. In addition, the lengthy amortization period provided under current law may contribute to undue manipulation of plan assumptions.

Explanation of Provision

Under the amendment, the period for amortizing experience gains and losses is reduced to 5 years from 15 years. The period for amortizing gains and losses from changes in assumptions is reduced to 5 years from 30 years.

Effective Date

The provision is effective for gains and losses arising in plan years beginning after December 31, 1987. The amendment does not affect the amortization period applicable to gains and losses arising in plan years beginning before January 1, 1988.

f. Actuarial assumptions must be reasonable (sec. 4556(b) of the bill)

Present Law

Under present law, the actuarial assumptions used to determine costs, liabilities, interest rates, and other factors under a plan are required to be reasonable in the aggregate. Present law does not require any individual actuarial assumption to be reasonable.

Reasons for Change

The present-law rule for actuarial assumptions presents significant compliance problems for the IRS. It is substantially more difficult for the IRS to establish that a plan's funding is determined on the basis of actuarial assumptions that are, in the aggregate, unreasonable than to challenge any individual assumption.

It is believed that these administrative problems reduce the ability of the IRS to require an employer to make plan contributions necessary to meet the plan's benefit obligations.

In addition, some employers who wish to maximize their tax deferral or obtain a larger tax deduction in a particular year use unrealistic actuarial assumptions (such as an extremely low interest rate assumption) in order to generate larger plan contributions and deductions. The inability of the IRS to challenge individual actuarial assumptions makes it more likely that employers who want to manipulate the present-law rules may do so.

Explanation of Provision

The amendment modifies the standard for actuarial assumptions to require that all costs, liabilities, interest rates, and other factors are to be determined on the basis of actuarial assumptions and methods (1) each of which is reasonable (taking into account the experience of the plan and reasonable expectations) or (2) which result, in the aggregate, in a total plan contribution equivalent to the contribution that would be obtained if each assumption were reasonable. Under the amendment, as under present law, the costs, etc., are required to represent the plan actuary's best estimate of anticipated experience under the plan. It is intended that the taxpayer has the burden of demonstrating that each actuarial assumption is reasonable and, if each actuarial assumption is not reasonable, that the assumptions in the aggregate result in a total contribution equivalent to the contribution that would be obtained if each assumption were reasonable.

Effective Date

The provisions are effective for plan years beginning after December 31, 1987.

g. Limitation on deduction for contributions to certain plans not less than unfunded current liability (sec. 4556(c) of the bill)

Present Law

Under present law, an employer may deduct contributions to a pension plan, within limits. In the case of a defined benefit pension plan, an employer's contributions to a plan may not be deductible even though the sum of the contributions plus the plan assets do not exceed the plan's current liability for the plan year.

Reasons for Change

Under the amendment, underfunded plans are subject to an exposure-related PBGC premium based on the amount of underfunding as a function of current liability. It is believed that it would be unfair to impose the exposure-related premium if the employer is willing to fund the plan up to the level of current liability.

Explanation of Provision

The amendment provides that the maximum deduction limit for contributions to certain defined benefit pension plans for a plan year is not to be less than the unfunded current liability for the plan. Current liability is determined as under the minimum funding rules. Thus, if the employer elects to take pre-participation service into account in calculating current liability under the minimum funding rules, such service is also taken into account in calculating current liability for purposes of this deduction rule. Except as provided by the Secretary, contributions to a defined benefit pension plan are deductible under this rule if the plan has 100 or more participants during the plan year. For purposes of the 100-participant rule, all defined benefit plans (including multiemployer plans) maintained by the same employer or any member of such employer's controlled group are to be treated as a single plan. With respect to multiemployer plans, only employees of the employer (or controlled group member) are taken into account.

Effective Date

The provision is effective for years beginning after December 31, 1987.

3. Treatment of Plan Terminations (secs. 4557-4559 of the bill)

Present Law

Law before 1986

Prior to 1986, an employer could, subject to contractual obligations, terminate a single-employer defined benefit pension plan at any time without regard to the financial health of the employer and without regard to the level of assets in the plan. If a terminated single-employer plan had assets that were sufficient to pay benefits at the level guaranteed by the PBGC, the plan was required to pay those benefits to participants and beneficiaries, and the employer had no liability to the PBGC. If a single-employer plan was

terminated with assets insufficient to pay benefits at the level guaranteed by the PBGC, the PBGC would pay unfunded guaranteed benefits. The employer was then liable to the PBGC for the insufficiency or for an amount equal to 30 percent of the employer's net worth, if less. The employer had no further liability to plan participants and beneficiaries.

SEPPAA

The Single Employer Pension Plan Amendments Act (SEPPAA), enacted in 1986, substantially modified the rules relating to the termination of single-employer defined benefit pension plans. Under SEPPAA, the conditions under which an employer may voluntarily terminate a plan were revised and an employer's liability to plan participants and the PBGC was increased in the case of a termination of an underfunded plan.

Guaranteed benefits

Subject to limits, the PBGC guarantees basic benefits under a plan. Basic benefits consist of nonforfeitable retirement benefits other than those benefits that become nonforfeitable solely on account of the termination of the plan. ERISA set the maximum guaranteeable benefit at $750 per month in 1974, to be adjusted annually based on the Social Security wage and benefit base. The maximum monthly amount for 1987 is $1,857.95.

Guarantees do not apply with respect to benefits in effect for fewer than 60 months at the time of plan termination unless the PBGC finds substantial evidence that the plan was terminated for a reasonable business purpose and not for the purpose of securing increased guaranteed benefits for participants. In cases in which they apply, guarantees are phased in at the rate of $20 per month or 20 percent per year, whichever is greater, for (1) basic benefits that have been in effect for less than 60 months at the time that the plan terminates, or (2) any increase in the amount of basic benefits under a plan resulting from a plan amendment within 60 months before the date of plan termination.

Standard terminations

After SEPPAA, a single-employer defined benefit pension plan may be voluntarily terminated only in a standard termination or in a distress termination. A plan may be terminated in a standard termination only if it has sufficient assets to pay all benefit commitments under the plan. Benefit commitments are greater than guaranteed benefits, and include all benefits guaranteed by the PBGC and all benefits that would be guaranteed but for the dollar limit on the guarantee or the length of time the benefit has been in existence (the phase-in rule). In addition, benefit commitments include early retirement supplements or subsidies and plant closing benefits with respect to participants who have satisfied all conditions for entitlement prior to termination, without regard to whether such benefits are guaranteed.

Benefit commitments are less than plan termination liability. Termination liability represents all benefits that have been promised under the plan up to the date of plan termination, and consists of all fixed and contingent liabilities to plan participants and bene-

ficiaries. Benefit commitments can be significantly less than termination liability. For example, benefit commitments do not include benefits that vest solely due to plan termination or contingent benefits (such as early retirement benefits) for which the participant has not satisfied all conditions for entitlement prior to termination; these benefits are, however, included in termination liability.

If a plan is terminated in a standard termination so that the plan assets are sufficient to satisfy benefit commitments, then the employer has no further liability to plan participants, even if the plan is not sufficiently funded to meet termination liabilities.

Distress terminations

A plan with assets insufficient to provide benefit commitments may be terminated in a distress termination only if the PBGC determines that each contributing sponsor and each substantial member of the contributing sponsors' controlled group satisfies at least 1 of 4 distress standards established by SEPPAA. An entity is a contributing sponsor if it (1) is responsible for funding the plan or (2) is a member of the controlled group of an entity that is responsible for funding, has been responsible for funding the plan, and has employed a significant number of participants under the plan while it was so responsible. The term "controlled group" means a group of entities under common control. A "substantial member" of a controlled group is generally any entity whose assets comprise at least 5 percent of the assets of the controlled group.

In order to terminate a plan in a distress termination, a plan administrator is required to demonstrate that each contributing sponsor and each substantial member of each contributing sponsor's controlled group meets one of the following criteria: (1) a petition in bankruptcy or a State insolvency proceeding has been filed seeking liquidation of the entity and the petition has not been dismissed; (2) a petition in bankruptcy or a State insolvency proceeding has been filed seeking reorganization of the entity (or a case described in (1) has been converted to a reorganization), the petition has not been dismissed, and the bankruptcy court has approved the plan termination; (3) unless a distress termination occurs, the entity will be unable to pay its debts when due and will be unable to continue in business; or (4) with respect to the entity, the costs of providing pension coverage have become unreasonably burdensome, solely as a result of a decline in the workforce covered as participants under single-employer defined benefit pension plans of which the entity is a contributing sponsor.

In a distress termination, if there are benefit commitments in excess of PBGC-guaranteed benefits that cannot be paid out of current plan assets ("outstanding benefit commitments"), then the PBGC is required to appoint an independent fiduciary with respect to a special termination trust maintained for the benefit of participants. Each contributing sponsor of the plan and each member of the controlled group of a contributing sponsor is jointly and severally liable to the termination trust for the lesser of (1) 75 percent of the outstanding benefit commitments, or (2) 15 percent of the total benefit commitments.

In general, payment of liability by a contributing sponsor to a termination trust is to be made under commercially reasonable

terms, with deferrals of certain amounts in years in which no person liable for the payment has pre-tax profits. Such deferred amounts are only payable after similar deferrals with respect to liability to the PBGC have been paid in full. However, there is no assurance that amounts will not be paid to plan participants before the employer's full liability to the PBGC has been discharged.

In a distress termination, if the plan assets are insufficient to fund guaranteed benefits, each contributing sponsor and each member of the controlled group of each contributing sponsor is jointly and severally liable to the PBGC for the sum of (1) the outstanding balance of any accumulated funding deficiency, and (2) the balance of the amount of any waived funding deficiencies. The full amount of a contributing sponsor's liability to the PBGC is due and payable as of the date of plan termination.

In addition, upon the termination of a plan pursuant to a distress termination, each contributing sponsor of the plan and each member of the controlled group of each contributing sponsor is jointly and severally liable to the PBGC for the sum of (1) the total amount of all unfunded guaranteed benefits, up to 30 percent of the collective net worth of the entities that are liable, (2) the excess of 75 percent of the unfunded guaranteed benefits over 30 percent of the collective net worth of the entities that are liable, and (3) interest on such amounts from the date of termination. Payment of this liability is generally to be made based on commercially reasonable terms, with deferrals of certain amounts in years in which the liable entities have no pre-tax profits.

The rules described above apply without regard to whether the employer or any member of the controlled group also maintains one or more plans that have assets in excess of termination liabilities.

PBGC claims in bankruptcy

Under present law, up to the 30-percent of net worth limit, the PBGC's claim has the priority status of a Federal tax for bankruptcy purposes. The remainder of the PBGC's claim generally has a lower priority status, that of an unsecured claim.

Termination by PBGC

The PBGC is authorized to commence proceedings to terminate a plan under certain circumstances and is required to do so if the plan does not have assets available to pay benefits that are currently due under the terms of the plan.

Reasons for Change

Standards for termination

The SEPPAA distress termination standards still permit ongoing, healthy companies to shift liabilities to the PBGC. Under SEPPAA, an employer in financial distress may terminate an underfunded plan pursuant to a reorganization while operating at a profit following the reorganization. This ability may also create a competitive disadvantage for other companies in the same industry that have not reorganized and have not reduced their liabilities. It

is believed that a distress termination should not be available in these circumstances.

Lien rules

While eliminating a reorganization as a condition permitting a distress termination, it is believed that it is appropriate to add safeguards to protect the PBGC's and participants' interest in a reorganization or other bankruptcy proceeding.

The GAO Report stated that, as of January 1986, the PBGC had recovered or expected to recover only 14 percent of its total claims in 1983-1985. The report concluded that this low recovery was due to 2 factors. First, recovery was low because the 30 percent of net worth limit on employer liability prevented the PBGC from recovering the full amount of guaranteed benefits. Second, the PBGC claim has priority status in bankruptcy only up to the 30 percent of net worth limit. Because most claims for due but unpaid contributions exceed this limit, they (with limited exceptions) have a low priority in bankruptcy, that of an unsecured claim. Contributions that were due but unpaid as of the termination were the cause of 30 percent of the PBGC's claims in 1983-1985.

The GAO report concluded that increasing liability to the PBGC would improve the recovery rate, but would not be sufficient to reduce the potential liability of the PBGC. According to the report, a major problem continues to be the low priority of PBGC claims in bankruptcy. SEPPAA increased the ability of the PBGC to secure its claim by requiring security in the case of certain funding waivers. Even if SEPPAA had been in effect with respect to the claims on the PBGC during 1983-1985, however, the GAO found that only 4 percent of the total claims for the period could have been secured by the PBGC. The report recommended that the priority of PBGC claims in bankruptcy be increased.

It is believed that appropriate measures are necessary in order to better protect the PBGC and plan participants in the case of bankruptcy. Accordingly, the amendment provides that the plan is entitled to security in certain cases in which there is risk of loss to the PBGC or plan participants.

Employer liability

Present law places limits on the liability of the employer to plan participants and the PBGC. Under present law, plan participants may lose their right to pension benefits if a plan is terminated with assets less than termination liability because the employer is not fully liable for unfunded benefits and because the PBGC has no liability for benefits in excess of guaranteed benefits. Similarly, if a plan terminates with assets less than guaranteed benefits, the PBGC may not be made whole with respect to the benefits it pays participants because the employer is not fully liable to the PBGC for unfunded guaranteed benefits.

The limits on employer liability under present law may also adversely affect the funding of plans because certain employers have insufficient incentive to fund a plan in excess of the level of benefit commitments. This disincentive may increase the likelihood that participants will not receive their full pension benefits and that the PBGC will have to provide unfunded guaranteed benefits.

In order to encourage employers to fund promised benefits, ensure that plan participants receive promised benefits, and ensure that the PBGC is made whole with respect to guaranteed benefits it pays, it is believed that employers should be fully liable for their pension promises.

Explanation of Provisions

Employer liability

Under the amendment, the required plan asset level for a standard termination is increased from the present-law requirement of benefit commitments to the full level of the plan's termination liability to participants. As under present law, the plan's termination liability is all liabilities to employees and their beneficiaries under the plan, and includes all fixed and contingent benefits that would be provided if the plan had sufficient assets (Code sec. 401(a)(2)). Of course, such liability is to be determined without regard to the level of plan assets.

Under the amendment, a defined benefit pension plan with assets insufficient to provide its termination liability to participants is unable to terminate unless the employer (and controlled group) can satisfy the criteria for a distress termination. Following a distress termination, the employer's (and controlled group's) liability to participants is increased from the present-law percentage of benefit commitments to the full amount of the plan's unfunded termination liability to the extent not guaranteed by the PBGC, and the employer's (and controlled group's) liability to the PBGC is increased to the full amount of unfunded guaranteed benefits.

Standards for termination

The amendment provides that a reorganization does not qualify as a condition under which a distress termination is permitted. Thus, under the amendment, in order to terminate a plan in a distress termination, a plan administrator is required to demonstrate that each entity that is a contributing sponsor or a member of a contributing sponsor's controlled group meets one of the following criteria: (1) a petition in bankruptcy or a State insolvency proceeding has been filed seeking liquidation of the entity and the petition has not been dismissed or converted to a petition seeking reorganization, (2) unless a distress termination occurs, the entity will be unable to pay its debts when due and will be unable to continue in business, or (3) with respect to the entity, the costs of providing pension coverage have become unreasonably burdensome, solely as a result of a decline in the workforce covered as participants under single-employer pension plans of which the entity is a contributing sponsor.

Lien rules

Consistent with the increase in the liability of the employer to the PBGC, the amendment removes the 30-percent of net worth limitation on the amount of the PBGC lien that arises upon plan termination.

In addition, under the amendment, a statutory lien arises in favor of the plan to the extent that as of the close of a plan year (1)

the plan's assets are less than 70 percent of current liability and (2) the unfunded current liability exceeds $25 million. The unamortized portion of the plan's unfunded old liability amount is disregarded in making these determinations. The lien is on all property and rights to property, whether real or personal, belonging to the contributing sponsor and the members of the contributing sponsor's controlled group.

The lien arises on the first day of the plan year following the plan year in which the determination is made, and continues until the close of the plan year in which the plan is not described in (1) or (2) above. If, from one plan year to the next, the level of unfunded current liability increases, the amount of the lien is increased by the amount of the increase in plan underfunding. The employer is required to notify the PBGC when the plan is described in (1) and (2) above.

Rules similar to the rules in section 4068(c), (d), and (e) of ERISA apply with respect to the lien and the amount on which it is based. As under section 4068(c), a perfected lien is treated as a Federal tax lien, and an unperfected lien is treated as a Federal tax claim. In addition, any lien created by this provision may be perfected and enforced by the PBGC or, at its direction, by the contributing sponsor or any member of the controlled group of the contributing sponsor.

Effective Dates

The provisionss are generally effective in the case of terminations where notice to the PBGC is provided after October 16, 1987, and terminations instituted by the PBGC after October 16, 1987. The provision creating a lien where unfunded current liability exceeds certain levels is effective with respect to plan years beginning after the date of enactment.

4. Employer Access to Assets of Overfunded Plans

Present Law

Access to plan assets

Under present law, a trust forming part of a pension plan is not qualified under the Code unless it is impossible under the trust instrument, prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the trust assets to be used for, or diverted to, purposes other than for the exclusive benefit of employees or their beneficiaries. However, upon termination of the plan and after satisfaction of all fixed and contingent liabilities of the participants and beneficiaries (termination liability), the employer may recover any excess assets remaining in the trust that are due to erroneous actuarial computations.

Similarly, under ERISA, the assets of an employee benefit plan may not inure to the benefit of any employer and are to be held for the exclusive purpose of providing benefits to participants in the plan and their beneficiaries and of defraying reasonable expenses of administering the plan. However, any excess assets of a plan may be distributed to the employer upon termination of the plan if

(1) all liabilities of the plan to participants and their beneficiaries have been satisfied, (2) the distribution does not contravene any provision of law, and (3) the plan provides for such a distribution.

Under present law, whether the employer has the right to the excess assets of a pension plan or is required to share the excess assets with plan participants is generally determined under the plan document. Thus, if the plan document provides that the employer is entitled to the reversion of excess assets, the employer is not required to share the reversion with participants. A majority of the cases provide that, subject to any applicable collective bargaining agreements, a plan may be amended at any time prior to termination of the plan to provide that the excess assets may revert to the employer.

Upon termination of a plan, all benefits as of the date of termination are required to become 100 percent vested and nonforfeitable. In addition, benefits generally are to be distributed or annuitized.

Implementation guidelines

Although an employer is not permitted to recover excess assets except upon termination of a plan, certain procedural guidelines permit transactions that, in effect, permit the withdrawal of assets from an ongoing plan. Typical examples of such transactions are termination-reestablishment and spinoff-termination transactions.

In a termination-reestablishment transaction, the employer terminates a defined benefit plan, recovers the excess assets, and then establishes a "new" plan that generally covers the same employees and provides the same or substantially similar benefits as the old plan. In a spinoff-termination transaction, a single plan is split into 2 plans, 1 plan covering retirees and 1 covering active employees. The excess assets are allocated to the plan covering retirees. That plan is then terminated, allowing the employer to recover the excess assets.

In response to concern that reversions can reduce the security of participants' benefits, procedural guidelines were developed jointly by the Department of the Treasury, the Department of Labor, and the PBGC. The procedures, referred to as the "Implementation Guidelines for Terminations of Defined Benefit Pension Plans" or the "Implementation Guidelines," were issued by the Administration as a news release on May 24, 1984.

The Implementation Guidelines set forth administrative procedures for processing certain terminations of qualified defined benefit pension plans involving reversions of excess assets to the plan sponsor. The guidelines generally provide that a bona fide termination of a defined benefit pension plan will be recognized as having occurred under either a spinoff-termination or a termination-reestablishment transaction only if certain conditions are met.

A spinoff-termination is considered bona fide under the guidelines only if (1) the benefits of all employees are vested as of the date of the termination; (2) all benefits accrued by all employees as of the date of the termination are provided for by the purchase of annuity contracts; (3) the continuing plan adopts a special amortization period (with the approval of the IRS); and (4) appropriate notice is provided to employees.

Under the Implementation Guidelines, termination- reestablishment transactions are generally recognized as bona fide. If the new plan provides credit for service before that plan was adopted, however, the guidelines do not treat the transaction as bona fide unless a special amortization period is adopted (with the approval of the IRS).

The guidelines note that spinoff-terminations or termination-reestablishments may affect the qualified status of plans because the Code requires that qualified plans be permanent. The guidelines generally provide that the permanency requirement prohibits an employer that has engaged in a spinoff-termination or termination-reestablishment transaction from engaging in another such transaction for at least 15 years.

Reasons for Change

It is believed that the present law standards, as reflected in the Implementation Guidelines, and the present-law excise tax on reversions are appropriate rules for addressing the issue of employer access to excess plan assets.

Explanation of Provision

The amendment confirms present law as contained in the Implementation Guidelines.

Effective Date

The provision is a clarification of present law.

5. Increase in PBGC Premium Rates (sec. 4560 of the bill)

Present Law

In general

The PBGC was created in 1974 by ERISA to provide an insurance program for benefits under defined benefit pension plans maintained by private employers. According to the PBGC's latest annual report, the single-employer insurance program currently covers more than 30 million participants in more than 110,000 defined benefit pension plans. PBGC revenues include premiums charged to defined benefit pension plans, earnings on investments, and collections from sponsors of terminated plans.

Premiums

Since its inception, the pension insurance program has charged a flat-rate premium based on the number of plan participants. ERISA initially authorized an annual per-participant premium of $1.00. The premium rate was raised to $2.60 for plan years beginning after December 31, 1977. SEPPAA increased the rate to $8.50, effective for plan years beginning after December 31, 1985.

Liability for premiums

Under present law, the plan administrator is liable for the payment of premiums.

Reasons for Change

In light of the PBGC deficit, a raise in the PBGC premium is needed. In its report, the GAO estimated that annual premium revenues of $446 million would be needed to retire a $4 billion deficit over 15 years at the PBGC's current interest rates. Projected annual revenue, however, is only $298 million, or 33 percent less than $446 million. Further, the GAO concluded that additional revenues would be needed to pay future expected claims and the program's administrative expenses.

It is believed that it is equitable to base the increased PBGC premium in part on the extent of a plan's underfunded status so that the premium reflects in part the potential PBGC liability created by the plan. However, basing the entire increase on a plan's underfunded status would unduly burden financially distressed plans and employers and could lead to a greater crisis for the PBGC if a significant percentage of these plans were terminated. Thus, it is believed that some of the necessary revenues should be derived from an increase in the flat premium.

As under the minimum funding rules, it is believed that the employer sponsoring a plan and related employers should be responsible for liabilities associated with the benefits promised under the plan. Thus, it is believed that the employer sponsoring the plan and all related employers should be liable for payment of the premium.

Explanation of Provision

Under the amendment, the flat-rate per-participant PBGC premium is increased to $14. In addition, the amendment applies an exposure-related per-participant premium based on the amount of potential liability the plan creates for the PBGC.

The exposure-related per-participant premium is determined by dividing an amount based on the plan's unfunded current liability by the number of plan participants in the plan at the end of the preceding plan year. The amount based on unfunded current liability is $6.00 for each $1,000 of unfunded current liability as of the end of the preceding plan year.

The additional per-participant premium is not to exceed $70 (indexed beginning in 1989 in accordance with the social security benefit and contribution base).

The $70 cap (indexed) is reduced in the case of certain plans. If an employer made the maximum deductible contributions to the plan for 1 or more of the 5 plan years preceding the first plan year beginning after December 31, 1987 (i.e., for a calendar year plan year, 1983-1987), then the cap on the exposure-related premium is reduced by $10 for each plan year for which such contributions were made. The $10 amount is indexed at the same time and same manner as the $70 cap. This special rule operates to reduce the exposure-related premium only for the first 5 plan years the premium is in effect.

As under the new funding rules, the exposure-related premium does not apply to any plan that has no more than 100 participants on each day of the preceding plan year. For purposes of this 100-participant rule, all defined benefit plans (including multiemployer

plans) maintained by the same employer (or any member of such employer's controlled group) are treated as one plan. With respect to multiemployer plans, only employees of the employer (or controlled group) are taken into account. In the case of a plan with more than 100 but less than 150 participants on each day during the preceding plan year, the amount of the exposure-related premium is determined by multiplying the otherwise required additional premium by 2 percent for each participant in excess of 100.

In addition, the special rule disregarding certain pre-participation service in calculating current liability under the funding rules applies in calculating current liability for purposes of the exposure-related premium. However, for premium purposes pre-participation years of service are taken into account if the participant has 5 or more years of service.

The amendment also provides that, with respect to a single-employer plan, the contributing sponsor, as well as the plan administrator, is liable for payment of the premium and that each member of the contributing sponsor's controlled group is jointly and severally liable for such payment.

Under the amendment, all amounts related to the exposure-related premium and the increase in the flat-rate premium are to be deposited in a separate revolving fund. Amounts in this fund may not be used to pay administrative costs of the PBGC or benefits under any plan terminated before January 1, 1988, unless no other amounts are available.

Effective Date

These provisions apply to plan years beginning after December 31, 1987.

6. Multiemployer Plans

The provisions described in 2 through 5, above, do not apply to multiemployer plans.

G. ESTATE AND GIFT TAXES

Retention of 1987 Rates for 2 Years (sec. 4561 of the bill and sec. 2001 of the Code)

Present Law

The estate and gift taxes are unified, so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. The generation-skipping transfer tax is computed by reference to the maximum Federal estate tax rate.

For 1987, the gift and estate tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach 55 percent on taxable transfers over $3 million. For transfers occurring after 1987, the maximum gift and estate tax rate is scheduled to decline to 50 percent for taxable transfers over $2.5 million.

Reasons for Change

It is inappropriate to permit revenue from existing taxes to be reduced at a time when additional revenues are needed to reduce the budget deficit.

Explanation of Provision

The scheduled decline in gift and estate tax rates is deferred for two years. The maximum rate declines to 50 percent for decedents dying, and gifts made, after December 31, 1989.

Effective Date

The provision is effective for decedents dying, and gifts made, after December 31, 1987.

H. EXCISE TAXES

1. Telephone Excise Tax: 3-Year Extension (sec. 4571 of the bill and sec. 4251 of the Code)

Present Law

A 3-percent excise tax is imposed on amounts paid for local telephone service, toll (long-distance) telephone service, and teletypewriter exchange service (Code sec. 4251). The tax is scheduled to expire after December 31, 1987.

Exemptions from the tax are provided for communications service furnished to news services (except local telephone service to news services), international organizations, the American National Red Cross, servicemen in combat zones, nonprofit hospitals and educational organizations, State and local governments, and for toll telephone service paid by a common carrier, telephone or telegraph company, or radio broadcasting company in the conduct of its business. Exemptions are also provided for installation charges, certain coin-operated service, and private communications systems (e.g., certain dedicated lines leased to a single business user).

Reasons for Change

It is inappropriate to permit existing taxes to expire at a time when additional revenues are needed to reduce the budget deficit. Therefore, it is felt that a 3-year extension of the telephone excise tax is appropriate in view of the existing budgetary deficit situation.

Explanation of Provision

The amendment extends the current 3-percent telephone excise tax for 3 years, through December 31, 1990.

Effective Date

The provision is effective for telephone bills rendered after December 31, 1987, and before January 1, 1991.

2. Collect Diesel Fuel and Special Motor Fuels Taxes on Sales to Retailer (sec. 4572 of the bill and sec. 4041, 4101, 6421, and 6427 of the Code)

Present Law

The diesel fuel and special motor fuels excise taxes generally are imposed on the sale of the taxable fuel by a retail dealer to the ultimate consumer of the fuel. Under an exception, retail dealers may elect to have wholesale distributors collect and pay the diesel fuel tax when the fuel is sold to the retailer.

Reasons for Change

Imposition of the tax at the retail level has fostered inefficient collection procedures and encouraged tax avoidance schemes because there are many tax collectors at the end of a long marketing chain. Imposing these taxes at an earlier stage in the marketing of these fuels would reduce opportunities for evading payment of the fuels taxes. Collection of excise taxes at the point in the distribution chain with a smaller number of taxpayers provides for more efficient administration of the tax since there are fewer taxpayers for the Internal Revenue Service to monitor. Furthermore, collecting these excise taxes at a uniform marketing level eliminates any special advantage for a single industry segment, e.g., integrated operations versus independent wholesale dealers.

Explanation of Provision

The excise taxes on diesel and special motor fuels and nongasoline aviation fuels are imposed on sales by importers and producers; wholesale distributors may elect to be treated as producers, if they satisfy registration and bonding requirements to be established by Treasury.

The provisions of present law permitting tax-free sales for certain exempt purposes are repealed. Instead, taxpayers who purchase such fuels for nontaxable uses may claim refunds or credit the amount of tax they paid against their income tax liability. In addition, Treasury is authorized to require such information reporting and registration that is necessary to prevent evasion of the tax.

Effective Date

The provision is effective on January 1, 1988.

3. Extension of Termination Date for Coal Excise Tax Rate (sec. 4573 of the bill and sec. 4121 of the Code)

Present Law

A manufacturer's excise tax is imposed on the sale or use of domestically mined coal by the producer (Code sec. 4121). Under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the rate of tax was increased, effective April 1, 1986, to $1.10 per ton of coal from underground mines, and 55 cents per ton of coal from surface mines, but not to exceed 4.4 percent of the sales price.

Amounts equal to the revenues collected from the coal excise tax are appropriated automatically to the Black Lung Disability Trust Fund. The Trust Fund pays certain black lung disability benefits to coal miners (or their survivors) who have been disabled by black lung disease in cases where no coal mine operator is found specifically responsible for the individual miner's disease.

Under present law, the tax rate is scheduled to revert to 50 cents on underground coal and 25 cents on surface coal (but not to exceed two percent of price) on the earlier of January 1, 1996 or the first January 1 as of which there is (1) no balance of repayable advances from the general fund to the Trust Fund, and (2) no unpaid interest on such advances.

Reasons for Change

It was concluded that the termination date for the coal excise tax rate presently in effect should be extended in order to provide for the long-term solvency of the Black Lung Trust Fund. As of the beginning of fiscal year 1987, the Trust Fund deficit (i.e., the amount of advances repayable to the general fund) was $2.9 billion.

Explanation of Provision

The termination date for the coal excise tax rate enacted in COBRA is extended from January 1, 1996 to the earlier of (1) January 1, 2014 or (2) the date the Trust Fund achieves solvency (as defined under the present-law termination provision).

Effective Date

The extension of the termination date for the present-law coal excise tax rate is effective from January 1, 1996 to January 1, 2014, subject to the solvency provision described above.

1. Railroad Retirement Provisions (secs. 4581-4584 of the bill and secs. 3201 and 2331 of the Code)

Present Law

The Railroad Retirement Program consists of a tier I benefit structure which is generally equivalent in benefits and financing to the Social Security program and a separately financed tier II benefit structure. Under present law, the tier II program is financed primarily by a payroll tax of 14.75 percent for employers and 4.25 percent for employees. This tax is applied to wages up to $32,700 per year. (This wage base amount is increased annually by the increase in average annual wages in the general economy.)

Tier II benefits are includible in income for income tax purposes in the same manner as benefits received under a qualified pension plan. However, the 1983 amendments to the Railroad Retirement Program appropriate from the general fund to the Railroad Retirement Account an amount equal to the increase in income tax liability that results from including tier II benefits in income. This appropriation to the Railroad Retirement Account is limited to an aggregate total of $877 million and applies only to benefits received prior to October 1, 1988.

Reason for Change

The 1983 amendments to the Railroad Retirement Program require an annual report on the solvency of the program. The 1987 report includes an analysis by the chief actuary of the program indicating that program is inadequately funded and recommending changes to address the situation. The chief actuary also recommends the establishment of a board to study whether fundamental changes in method of paying for the program need to be considered by the Congress.

Explanation of Provisions

Increase in railroad retirement tax

The provision increases the employer tier II tax by 1.35 percentage points to 16.1 percent. The employee rate is increased by 0.65 percentage points to 4.9 percent.

Commission on Railroad Retirement Reform

The provision also establishes an eight-member Commission to study alternative methods of securing the long-range solvency of the Railroad Retirement Program. The President is to appoint four members, representing railroad management, railroad labor, commuter railroads, and the general public. The President pro tempore

of the Senate is to appoint two members representing the general public after consultation with the Chairmen of the Senate Committees on Finance and on Labor and Human Resources. The Speaker of the House of Representatives is to appoint two members representing the general public after consultation with the Chairmen of the Committees on Ways and Means and on Energy and Commerce. The Commission is to submit its findings to the Congress by October 1, 1989.

The provision also eliminates the $877-million limit on the amount of general funds that are appropriated to the Railroad Retirement Account on the basis of income taxes on tier II benefits, and provides that such appropriations will be made for two additional years based on tier II benefits paid through September 30, 1990.

Effective Date

The tax rate increases are effective for wages paid after December 31, 1987. The other provisions are effective upon the date on enactment.

2. FUTA Tax: Three-Year Extension of Repayment Tax; Transfer of Funds into the Federal Unemployment Account (secs. 4585-4586 of the bill, sec. 3301 of the Code, and sec. 90 of the Social Security Act)

Present Law

The Federal Unemployment Tax Act (FUTA) generates revenues which are allocated among several accounts in the Federal Unemployment Trust Fund. Funds in the Employment Service Administration Account are used to meet the Federal and State administrative costs of operating unemployment compensation programs and most of the cost of Employment Service operations. The Extended Unemployment Compensation Account (EUCA) is used to meet half the cost of extended unemployment benefits (EB), which are paid in times of unusually high unemployment. (The other half of EB costs are funded from State unemployment taxes.) The Federal Unemployment Account (FUA) is a reserve account from which States may borrow funds in the event the State unemployment account is temporarily unable to meet benefit liabilities.

Each of these accounts in the Trust Fund has a statutory ceiling. When the ceiling is reached, excess funds are distributed among the account according to rules specified in Title IX of the Social Security Act. When all of these accounts reach their ceiling levels, any excess amounts would be distributed to the State unemployment accounts in the Trust Fund.

The gross Federal unemployment tax rate is 6.0 percent, plus a temporary 0.2-percent rate enacted in 1976. In general, employers qualify for a credit of 5.4 percentage points against this tax, leaving a net Federal tax of 0.6 percent plus the temporary 0.2 percent. The tax is paid by employers on the first $7,000 of annual earnings of each employee. (In some States, the 5.4-percent credit is reduced to recover outstanding State loans from FUA.)

The temporary 0.2-percent additional rate was added in order to repay borrowing of the Federal Unemployment Trust Fund from the general fund of the Treasury during the mid 1970's. The outstanding indebtedness was repaid this year, and the additional tax will terminate at the end of 1987.

Reasons for Change

While the EUCA account has fully repaid the outstanding borrowing from the general fund of the Treasury, the experience of the 1970's indicates that the Unemployment Fund may need to accumulate a higher level of reserves than provided under present law, in order to have reasonable assurance of weathering economic cycles without undue reliance on general fund borrowing.

Explanation of Provisions

The temporary 0.2-percent additional FUTA tax rate is to be continued for three additional years, through 1990. The statutory ceilings on the EUCA and FUA accounts are increased in order to accommodate the additional revenue generated by extending the tax rate. The EUCA account ceiling is increased from 1/8 of the amount of total annual wages to 3/8 of total annual wages. The FUA account ceiling is increased from 1/8 of total annual wages to 5/8 of total annual wages.

Effective Date

The provision is effective for wages paid during calendar years 1988 through 1990.

3. FICA Tax Provisions

a. Expand employer share of FICA tax to include all cash tips (sec. 4587 of the bill and sec. 3121(q) of the Code)

Present Law

The FICA taxes imposed on the employee and the employer generally are equal. The employer is responsible for withholding the employee's share of the tax from the employee's wages and remitting the tax, together with the employer's share of the tax, to the Internal Revenue Service.

Special rules apply to tips. For purposes of the employee FICA tax, all tips received by an employee are considered remuneration for services and are subject to the tax. The tips generally are deemed to be received at the time the employee files a written statement with the employer reporting the receipt of the tips. Tips are subject to FICA taxes only in the case of employees who receive at least $20 in cash tips in a month. Tips in a medium other than cash are not subject to FICA taxes.

However, the full amount of tips received by an employee usually is not subject to the FICA tax imposed on the employer. For purposes of the employer's share of FICA taxes, the employee is deemed to receive wages only to the extent of the excess of the Federal minimum wage rate over the actual wage rate paid by the employer. Any tips received in excess of the difference between the

wages paid and the minimum wage are not subject to the employer's portion of the tax.

Reasons for Change

Under present law, an employee is required to pay FICA taxes on the total amount of his or her cash tips up to the Social Security wage base. The employer, however, is required to pay FICA taxes only on a portion of the tips. Because Social Security benefits are determined with respect to the entire amount of tips, current law in effect provides a benefit to employers whose employees receive part of their compensation in the form of tips, as compared to other employees who receive all their compensation as salaries. It is believed that to apportion the costs of Social Security benefits more accurately, employers should be subject to tax on all tips which are credited for benefit purposes.

Explanation of Provision

Under this provision, all cash tips which are subject to the employee FICA tax are included within the definition of wages for purposes of the employer's share of FICA taxes. Thus, employers must pay FICA taxes on the total amount of cash tips and other remuneration, up to the Social Security wage base.

Effective Date

This provision is effective for remuneration received on or after January 1, 1988.

b. Extend FICA tax to include inactive duty earnings of military reservists and certain other earnings (secs. 4588, 4589, 4591, and 4592 of the bill and secs. 209 and 210 of the Social Security Act)

Present Law

Under present law, certain forms of earnings paid to employees are exempt from FICA taxes. These earnings include the following:

Armed Forces reservists.—Approximately 1.4 million Armed Forces reservists do not receive credit for Social Security benefits and are not subject to Social Security (FICA) taxes for inactive duty earnings paid for "inactive duty training." Earnings from full-time active duty or from "active duty for training" (training sessions lasting several weeks) constitute covered employment under current law.

Agricultural workers.—Cash remuneration paid to an employee in any taxable year for agricultural labor is excluded from the definition of wages unless the employee receives more than $150 during the year for such labor or the employee works for the employer more than 20 days during the year and is paid on a time basis.

Individuals aged 18-21.—Services performed by individuals under age 21 who are employed by their parents, even if employed in the parent's trade or business, do not constitute covered employment under present law.

80-012 O - 87 - 4

Spouses.—Services performed by an individual in the employ of a spouse do not constitute covered employment.

Reasons for Change

It is believed that the wages of the particular groups of employees described above should receive the same treatment generally accorded other wages for FICA tax purposes. These provisions also ensure that these individuals receive Social Security coverage (including disability and survivor benefits).

Explanation of Provision

The amendment extends credit toward Social Security benefits, and imposed FICA taxes, with respect to services performed by reservists in "inactive duty training"; to services performed by individuals aged 18-21 working for their parents in a trade or business; and to services performed by an individual in the employ of his or her spouse's trade or business.

The amendment also requires, with respect to agricultural labor, that: (1) any remuneration for agricultural labor paid by an employer to an employee constitutes wages for FICA purposes if the employer pays more than $2,500 to all employees for such labor during the taxable year; (2) the $150 annual cash pay test is to be applied if the $2,500 annual payroll test is not met; and (3) the 20-day test be eliminated.

Effective Date

These provisions are effective January 1, 1988.

c. Treatment of group-term life insurance as wages under FICA (sec. 4590 of the bill and sec. 209 of the Social Security Act)

Present Law

The cost of group-term life insurance provided by an employer to an employee is excluded from the definition of wages for purposes of the FICA tax. For income tax purposes, the cost of employer-provided group-term life insurance is includible in an employee's gross income to the extent that the coverage exceeds $50,000. Additionally, the total amount of employer-provided group-term life insurance is included in an employee's gross income to the extent that the coverage is provided on a discriminatory basis (sec. 89).

Reasons for Change

It is believed that the FICA tax treatment of group term life insurance provided by an employer for an employee should be conformed to the treatment of such benefit for income tax purposes.

Explanation of Provision

The provision treats the cost of employer-provided group-term life insurance as wages for FICA tax purposes to the extent such cost is includible in gross income for income tax purposes.

Effective Date

The provision is effective January 1, 1988.

J. USER FEES

1. Internal Revenue Service Fees (sec. 4595 of the bill)

Present Law

The Internal Revenue Service (IRS) currently provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS responds to these inquiries through the issuance of letter rulings, determination letters, and opinion letters.

A letter ruling is a written statement issued by the National Office of the IRS that interprets and applies the tax law to a specific set of facts. A letter ruling generally is followed by the IRS on audit in determining the tax liability of the recipient of the ruling.

A determination letter is a written statement issued by a district director of the IRS that applies principles previously announced by the National Office of the IRS to a specific set of facts. A determination letter generally is issued in the same circumstances as a letter ruling and is followed by the IRS on audit in determining the tax liability of the recipient of the letter. Most determination letters involve the qualification of retirement plans and the status of organizations seeking exemption from tax.

An opinion letter is a written statement issued by the National Office of the IRS that addresses the acceptability of the form of a master or prototype pension plan and any related trust or custodial account.

The IRS currently does not charge taxpayers for issuing letter rulings, determination letters, or opinion letters.

Reasons for Change

It is believed that, as the Administration has proposed in the last several budgets, the relatively small number of persons that request letter rulings, determination letters, and opinion letters should pay for the benefit of these services. It is also believed that the provision should not be made permanent at this time so that the Congress may examine the impact of the provision on taxpayer compliance.

Explanation of Provision

The amendment requires the IRS to charge a fee for each request for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. The amount of the fee is to vary based on the type of request, as follows:

Category	Fee
Employee plan ruling and opinion	$400
Exempt organization ruling	$320
Employee plan determination	$250
Exempt organization determination	$200
Chief counsel ruling	$200

The IRS is authorized to vary the amount of the fee charged for subcategories of requests based on the average time for (and the difficulty of) complying with requests in the subcategories. In addition, the IRS is authorized to provide exemptions and reduced fees. The IRS may vary the amount of the fee or provide exemptions or reduced fees only if the average fee charged during a fiscal year for requests in any category is not less than the fee listed above for that category.

The amount of the fee is payable in advance and is refundable only if the IRS refuses to respond to the request. The fee is not refundable if the person making the request withdraws the request prior to the issuance of the ruling or determination.

Effective Date

The provision applies to requests filed on or after the first day of the second calendar month that begins after the date of enactment. The provision does not apply to requests filed after September 30, 1990.

2. Extensions and Increases in Certain Alcohol, Tobacco, and Firearms Occupational Taxes (sec. 4596 of the bill and secs. 5091, 5111, 5121, 5131, 5271, 5801, and 5845 of the Code)

Present Law

Occupational taxes are imposed on numerous business activities involving the production and marketing of alcohol, tobacco, and firearms products. Brewers currently pay $110 per year for each brewery operated by them, except any brewer of fewer than 500 barrels a year pays $55 per year (sec. 5091). Manufacturers and importers of National Firearms Act (NFA) firearms pay a $500 per year occupational tax for each place of business, except a person who manufactures or imports only weapons classified as "any other weapon" under section 5845(e) pays a tax of $25 per year (sec. 5801). No occupational taxes are imposed on distillers, wineries, or tobacco manufacturers.

Dealers in NFA firearms generally are subject to an annual occupational tax of $200 per place of business; dealers who deal only in weapons classified as "any other weapon" under section 5845(e) are subject to an annual tax of $10 per place of business (sec. 5801).

An annual $255 per place of business occupational tax is imposed on wholesale liquor dealers; an annual $123 tax is imposed on wholesale beer dealers (sec. 5111).

An annual occupational tax of $54 per place of business is imposed on retail liquor dealers; the tax is $24 per place of business for retail beer dealers (sec. 5121). A special tax of $4.50 per month in which sales are made is imposed on "limited retail dealers" in

distilled spirits; the tax is $2.20 per month for limited retail dealers in beer and wine only (sec. 5121).

Persons permitted to use distilled spirits without payment of tax, or who deal in or use specially denatured distilled spirits, must obtain permits under present law, but no occupational tax is imposed on these persons with respect to this activity (sec. 5271).

Present law permits drawbacks (refunds) of the distilled spirits tax in certain cases. Persons receiving drawbacks of this tax for distilled spirits to be used for nonbeverage purposes are subject to an occupational tax based on the amount of alcohol used. The tax ranges from $25 per year (drawbacks not exceeding 25 proof gallons) to $100 per year (drawbacks exceeding 50 proof gallons) (sec. 5131).

Reasons for Change

The Bureau of Alcohol, Tobacco, and Firearms (BATF) incurs significant expenses in regulating the three industries over which it has jurisdiction. The President proposed in his budget that the direct beneficiaries of these regulatory provisions pay a greater share of the costs incurred by BATF.

The amendment generally concurs with the President's proposal. It was determined that the appropriate way to accomplish the proposal was to increase the present occupational taxes, which generally have not been increased since the early 1950s, and to impose those taxes more uniformly across the businesses affected.

Explanation of Provisions

The present producer/manufacturer occupational taxes are increased to annual amounts of $1,000 per place of business for producers of all taxable alcoholic beverages (distilled spirits, wine, and beer), manufacturers of all taxable tobacco products, and for firearms producers. A special rate of $500 per year applies to businesses having gross receipts of less than $500,000 in the preceding taxable year. For purposes of this special rate, all members of a controlled group of corporations (substituting 50 percent for the general 80 percent test of control) are treated as one business.

The present firearms dealer occupational tax is increased to $500 per year per place of business.

The present alcoholic beverage wholesale dealer occupational taxes are combined and imposed at an increased rate of $500 per year per place of business.

The present alcoholic beverage retail dealer occupational taxes are combined and imposed at an increased rate of $250 per year per place of business. The present occupational taxes on limited retail dealers are repealed. The retail dealer occupational tax further is extended to all persons required to acquire permits for tax-free use of distilled spirits under section 5271.

The three occupational tax rates for persons receiving drawbacks of the distilled spirits tax for spirits used in nonbeverage products are combined and increased to $500 per year per place of business.

Effective Date

These provisions are effective on January 1, 1988.

As under present law, the occupational taxes generally will continue to be paid for a period of 12 months, covering the period July 1-June 30. Thus, subject to special rules for the period January 1-June 30, 1988, all persons subject to tax under the provisions of the bill are liable for the entire annual tax on July 1, 1988.

For the period January 1-July 1, 1988, a series of special rules will apply. Persons initially subject to tax as a result of the provisions are liable for a tax equal to one-half of the otherwise applicable annual rate on January 1, 1988.

In the case of persons who paid an occupational tax during calendar 1987, for which no further tax is due until July 1, 1988, under present law, a tax is due on January 1, 1988, in an amount equal to one-half of the excess of the new tax rate for the occupation involved over the present-law rate.

3. Customs User Fees (sec. 4597 of the bill)

Present Law

As enacted in the Omnibus Budget Reconciliation Act of 1986, an *ad valorem* user fee is applied to all formal entries of merchandise imported for consumption in the amount of 0.22 percent during fiscal year 1987, dropping to the lesser of 0.17 percent or the rate which will provide revenue equal to the appropriated level of customs' commercial operations in fiscal year 1988, and expiring September 30, 1989. The fee does not apply to articles classifiable in schedule 8 of the Tariff Schedules (including products containing U.S. components which are classifiable in item 807.00 of the Schedules and U.S. articles returning to the United States after having been processed abroad which are classifiable in item 806.30).

Reasons for Change

The customs user fees provisions are amended in response to concerns expressed by the Administration and the trading community based on experience with the users fees over the past year.

The Administration's budget proposal would have extended the customs users fees indefinitely and modified the schedule 8 exemption insofar as it applies to imported articles containing U.S. components. Although it is intended to adopt the Administration's recommendation with respect to the schedule 8 exemption, the program is extended for one additional year, to September 30, 1989, rather than extending it indefinitely. It is also intended that the amendment relate to a number of concerns about the way the program has been administered thus far which the Senate would like to see addressed satisfactorily before it will consider making this program permanent.

It is further intended that the amendment relate to particular concerns that the fundamental purpose of the program of providing adequate funding for the commercial operations of the Customs Service is not being met. During the first year of the program, the Office of Management and Budget did not allow any of the proceeds of the customs users fees account to be spent for the commer-

cial operations of the Customs Service. Further, the Administration's budget proposal for the Customs Service for fiscal year 1988 once again called for a drastic reduction of 2,000 customs officers. Such cuts should not be necessary if the customs users fees program is being properly implemented.

The intention also is that the amendment modify current law dealing with the disposition of user fees and the manner of their application to fund Customs' commercial operations. This modification is designed to clarify current law in order to obviate administrative problems which have arisen from OMB's interpretation of current law. Under its interpretation, OMB has seen fit to maintain two user fees accounts, one for passenger and conveyance fees and another for the commercial operations fee on imports. Because certain legal requirements, such as the procedure for recommending an increase or decrease in user fees, are triggered by the user fee account balance in relation to expenditures, it is believed that administration and oversight will be simplified if only a single Customs User Fees Account is established. All users fees are required to be deposited in a single Customs User Fees Account. Current law is to be further clarified by reiterating that funds deposited in the Customs User Fees Account be employed, to the extent provided in appropriations acts, to reimburse all costs of the Customs Service for commercial operations. Finally, the intention is to include provisions designed to ensure that operators of foreign trade zones and customs bonded warehouses would no longer be, in effect, assessed twice for customs transactions occurring at such facilities.

Explanation of Provision

The amendment changes these user fees provisions. First, the expiration date for the fees would be extended for one additional year, until September 30, 1990. Second, in order to avoid placing a double burden on operators of foreign trade zones and customs bonded warehouses, a provision has been added precluding the Customs Service from assessing an annual fee on such operators in addition to the per-entry fee that is now applicable to merchandise withdrawals from such facilities.

Third, the amendment changes provisions of present law that permit importers to avoid the application of the users fees entirely if any portion of the imported article is of U.S. origin and eligible for duty-free treatment under items 806.30 or 807.00 of the Tariff Schedules. As amended, only the value of the U.S. components or materials which are eligible for duty-free treatment under such provisions would be exempt from the users fee. The value of the foreign components of the imported article would be subject to the fee.

To ensure that no additional recordkeeping burdens are imposed upon the public as a result of this amendment, the following simplified accounting requirements applicable to *duty-free* articles entering, or eligible for entry, under items 806.30 and 807.00 of the Tariff Schedules of the United States (TSUS) should be implemented. These requirements would apply to all imports of: (1) articles with U.S. content; (2) commingled merchandise consisting of arti-

cles with U.S. content and like or similar articles not containing U.S. content; and (3) articles exported from the United States for processing abroad and returned to the United States for further processing.

Importers may enter the articles on the basis of aggregate data derived from financial and manufacturing reports used by the importer in the normal course of business. The data would be calculated according to generally accepted accounting principles so as to establish the following for a one-year period: (1) the total value of all articles imported, based on U.S. customs principles of valuation; (2) for item 807.00 articles, the U.S. content portion of the value cited in item 1 value represented by processing abroad; and (3) for item 806.30 articles, the portion of the item 1 value represented by processing abroad. In this context, the valuation of all imports during an import year would be based on data from the prior import year and applied across-the-board to such imports, thereby eliminating discrete calculations with respect to articles, individual components contained within such articles, and individual entries. Accordingly, 1986 data would apply to 1987 imports, 1987 data to 1988 imports, and so on. It is intended that the term "import year" be defined as either a calendar year or some other 12-month cycle, depending on the accounting cycle utilized by the importer.

Upon termination of operations by an importer, a "catch-up" adjustment reflecting actual percentages from the year prior to the termination would be required to ensure that the importer has paid the appropriate amount of user fee. With the exception of this adjustment, or unless required by a Customs audit, no other adjustment or reconciliation in connection with user fee payments shall be required of the importer.

Fourth, the amendment adds clarifying language regarding the customs user fees. In the Budget Reconciliation Act of 1986, Congress required that the fees were to be placed in a dedicated account for expenditures for commercial operations of the Customs Service. The new language specifies that the fees are to be treated as receipts offsetting expenditures of salaries and expenses for commercial operations. The purpose is to make clear that it is inappropriate to treat the fees as revenues, as the Administration has done. In addition, the section clarifies that the user fees on passengers and conveyances are to be deposited in the same dedicated account as the ad valorem fees and, to the extent they are not needed to reimburse the Customs Service for expenses incurred in providing overtime inspectional services, they are to be used as receipts offsetting commercial operations expenditures.

K. COLLECTION OF NONTAX DEBTS OWED TO FEDERAL AGENCIES

3-Year Extension (sec. 4601 of the bill, sec. 6402 of the Code, and sec. 3720A of title 31, United States Code)

Present Law

Certain Federal agencies are authorized to notify the IRS that a person owes a past due, legally enforceable debt to the agency. The IRS then must reduce the amount of any tax refund due the person by the amount of the debt and pay that amount to the agency. This program expires after December 31, 1987.

Before a refund can be offset under this program, the agency which is owed a debt must certify to the Treasury that the debtor has been notified about the proposed offset and has been given at least 60 days to present evidence that all or part of the debt is not past due or not legally enforceable. If a refund otherwise due an individual is subject to offset both under this provision and because of AFDC past-due support, the offset for AFDC past-due support is implemented first.

Under IRS regulations, the program only affects refunds due individuals, not corporations.

Reasons for Change

A 3-year extension of the debt collection provisions is believed to be appropriate so that the Federal Government can use every means available to collect debts owed to Federal agencies that the agencies have been unable to collect themselves. It is not believed to be appropriate to permit existing debt collection provisions to expire at a time when additional revenues are needed to reduce the budget deficit. Moreover, expanding the debt collection program to apply to debts owed to all Federal agencies by individuals or corporations should enhance the effectiveness of the program.

Concern was also expressed, however, about the possible negative effect of this program on voluntary tax compliance. Therefore, the provision is extended for 3 years, which would provide the Congress with an additional opportunity to assess the effect of the program on voluntary tax compliance. Also, GAO is required to report on the impact of this program on voluntary tax compliance. This report will be an important element in assessing the effectiveness of the program.

Explanation of Provision

The amendment extends for 3 years the tax refund offset program. In addition, the amendment expands the scope of the program in two ways. First it applies to debts owed to all (not just se-

lected) Federal agencies. Second, it applies to debts owed by either individuals or corporations.

Prior to the enactment of this amendment, some Federal agencies may take actions to notify a debtor of a proposed offset and to certify to the Treasury that a debt is owed, as required by section 3720A of title 31, United States Code. It is intended that these agency actions not be affected by the fact that they were taken before Congress enacted this 3-year extension of the Federal debt collection program.

Prior to the expiration date of December 31, 1990, this provision should be evaluated to determine the extent to which it facilitates the collection of debts owed the Federal Government and increases the amount of debts collected, as well as to examine the effects of this provision on voluntary taxpayer compliance with the income tax law. Therefore, GAO, in consultation with the Secretary of the Treasury, is required to report to the Congress on the effects of this program on voluntary tax compliance. This report is to provide and analyze data on the effects of the program, such as whether taxpayers whose refunds are offset continue to file tax returns and whether those taxpayers adjust their withholding so as to create additional tax collection difficulties.

Effective Date

The provision is effective on January 1, 1988, and expires after December 31, 1990. The report is due on April 1, 1989.

L. ESTATE TAX DEDUCTION FOR SALES TO AN ESOP

(Secs. 4611-4613 of the bill, sec. 1172 of the Reform Act, and secs. 409 and 2057 of the Code)

Present Law

In general

The Tax Reform Act of 1986 (sec. 1172 of the Act and sec. 2057 of the Code) adopted a special provision allowing partial relief from estate taxes through an estate tax deduction for sales of employer securities to an employee stock ownership plan (ESOP) or an eligible worker-owned cooperative. This provision was adopted for a temporary period of time to encourage transfers of employer securities to ESOPs. The provision permits a deduction from the gross estate of a decedent equal to 50 percent of the proceeds received from a qualified sale of employer securities. Under the Act, a qualified sale is any sale of employer securities by the executor of an estate to an ESOP or an eligible worker-owned cooperative.

IRS Notice

IRS Notice 87-13 (January 5, 1987) provided that the estate tax deduction for transfers to an ESOP or worker-owned cooperative is not available unless (1) the decedent directly owned the employer securities immediately before death, and (2) after the sale, the employer securities are allocated to plan participants or are held for future allocation in connection with an exempt loan under section 4975 or in connection with a transfer of assets from a defined benefit plan under the rules of section 4980(c)(3). Except in the case of a bona fide business transaction, employer securities are not treated as allocated or held for future allocation to the extent that such securities are allocated or held for future allocation in substitution of other employer securities that had been allocated or held for future allocation.

Reasons for Change

In enacting the estate tax deduction, Congress intended that it would be utilized in a limited number of transactions with a relatively modest revenue loss. As drafted, the estate tax deduction was significantly broader than what was originally contemplated by Congress in enacting the provision. It is necessary to conform the statute to the original intent of Congress in order to prevent a significant revenue loss under the Tax Reform Act of 1986.

While Congress intended to encourage transfers of employer securities to ESOPs by providing for partial elimination of estate tax liability, it was not intended that estates be able to eliminate all estate tax liability through use of the deduction or that the securi-

ties acquired in a transaction for which the deduction was claimed need not be allocated to plan participants. The provision would not have been adopted in its present form had the full extent of the revenue impact and effect of the provision been recognized.

It is now necessary to modify the provision to bring the revenue loss in line with the original estimate and Congressional intent. The modifications contained in the amendment (which are essentially identical to modifications proposed in S. 591, introduced by Senator Bentsen) are designed to achieve this result while maintaining to the fullest extent possible the incentive to transfer employer securities to ESOPs.

The primary thrust of the amendment is to conform the provision to the original intent of Congress in enacting the deduction. In this respect, the amendment has two elements.

First, the amendment makes clear that the positions taken by the Internal Revenue Service in Notice 87-13 with respect to the estate tax deduction are an accurate statement of Congressional intent in enacting the provision. If these clarifications are not made, taxpayers could qualify for the deduction by engaging in essentially sham transactions.

Second, the amendment makes additional changes in the deduction which more fully effectuate the intent of Congress to provide limited relief from the estate tax. These changes will give taxpayers and the Internal Revenue Service more administrable guidance as to the requirements that must be satisfied by the decedent and the ESOP and the consequences of failing to satisfy these requirements.

Explanation of Provisions

Confirmation of IRS Notice

The amendment confirms the positions taken in IRS Notice 87-13.

Tax-credit ESOPs

The amendment clarifies that the estate tax deduction is available in the case of sales of employer securities to tax-credit ESOPs (sec. 409(a)).

Nonpublicly traded stock

The amendment limits the deduction to sales of employer securities which are issued by a domestic corporation that has no stock outstanding that is readily tradable on an established securities market.

Estate requirements

Sale by executor.—As enacted, section 2057 would have applied only with respect to sales by the executor of an estate. There are significant issues and potential inconsistencies created by this language. For example, it is common for individuals to structure their estates so that not all the assets are included in the probate estate and subject to the control of the executor. Assets may be in a revocable trust or other similar arrangement which is excluded from the probate estate. In the case of assets held in trust, the statute

could be interpreted to preclude the sale of such assets in a transaction qualifying for the estate tax deduction because the executor cannot sell the trust assets.

Congress, in enacting the estate tax deduction, did not intend to draw arbitrary distinctions among the types of assets includible in the gross estate of a decedent depending upon whether the assets are within the control of the executor.

The amendment clarifies that the provision applies to sales of employer securities to the extent the securities are includible in the gross estate. Thus, assets held in trust are eligible for the estate tax deduction to the extent the employer securities held by the trust are listed as securities on the estate tax return. On the other hand, if a decedent owned a partnership interest, the value of the partnership interest is reported on the estate tax return and not the value of the underlying assets of the partnership. Consequently, under the provision, if the assets of a partnership consisted of employer securities, such securities may not be sold in a transaction qualifying for the estate tax deduction.

Limitation on deduction.—In order to ensure that the provision results in only a partial elimination of estate tax liability, the amendment limits the amount of the deduction allowable under section 2057 to 50 percent of the taxable estate (determined without regard to sec. 2057). Also, the amount of estate taxes imposed by section 2001 (determined without regard to any credits allowable against the tax) may not be reduced by more than $750,000 by reason of the deduction.

Holding period requirement.—In order to prevent transfers in contemplation of death, the amendment imposes a holding period requirement for the decedent with respect to the employer securities to be sold to an ESOP. Thus, in order for the estate tax deduction to be available, the securities are required to be assets that would be includible in the gross estate of the decedent if the decedent died at any time during the shorter of (1) the 5-year period ending on the date of death, or (2) the period beginning on October 22, 1986, and ending on the date of death. For purposes of determining whether the holding period requirement has been satisfied, securities which would be includible in the gross estate of the spouse of the decedent if the spouse died during the holding period are to be treated as securities includible in the gross estate of the decedent during such period. In the case of the estate of a decedent who died before October 22, 1986, the holding period requirement is satisfied if the decedent held the employer securities on the date of death.

The period for which the decedent is considered to have held the stock is reduced for any period for which the holding period is reduced under section 246(c)(4) (relating to periods in which the risk of loss is diminished).

Assets transferred from other plans.—The amendment provides that the estate tax deduction does not apply to the extent that the employer securities are acquired with transferred assets. Transferred assets are assets of an ESOP which are attributable to assets held by another qualified plan maintained by the employer (other than another ESOP) or assets attributable to a period of time when a plan was not an ESOP. Assets held by the ESOP on February 27,

1987, are not transferred assets, regardless of their source. The denial of the deduction extends to assets that are transferred directly from one plan to another (for example, pursuant to section 4980(c)(3)), assets which are rolled over from another plan, assets which result from a conversion of another plan into an ESOP, and assets which are merged into an ESOP from another plan (other than an ESOP). The Secretary has the authority to except assets from this provision under appropriate circumstances.

In order to prevent the employer from acquiring securities in a section 2057 transaction with the proceeds of a loan and then using transferred assets to make payments on the loan, the amendment imposes an excise tax if a loan payment is made with transferred assets. The tax is imposed on the employer maintaining the ESOP and is equal to 30 percent of the amount paid on the loan (including both principal and interest payments). This provision is not intended to expand the permissible sources from which exempt loans can be repaid pursuant to section 4975.

ESOP allocation requirements and substitution prohibition

In general.—The amendment modifies the allocation requirement and nonsubstitution requirement in present law (as reflected in the IRS Notice) in several respects. The modifications provide objective rules for determining when a prohibited substitution of employer securities occurs and also change the sanctions for failing to allocate the securities acquired in the section 2057 transaction or acquiring securities in substitution for other employer securities. The new provisions are intended to ensure that plan participants receive the employer securities acquired in a section 2057 transaction (or the proceeds of a disposition thereof) and that the transaction results in an increase in employer securities in the plan.

Dispositions within 1 year preceding sale.—The amendment prohibits an ESOP from selling employer securities and using the proceeds to acquire substitute employer securities in a section 2057 transaction. Further, the amendment modifies this nonsubstitution rule contained in present law (as reflected in the IRS Notice) to provide that the deduction is available with respect to proceeds from a sale to an ESOP only to the extent the proceeds are greater than the excess (if any) of (1) the proceeds from the disposition of employer securities during the 1-year period preceding the sale, over (2) the cost of employer securities purchased by the plan during such 1-year period. In addition, for purposes of the rule, all ESOPs of the employer are treated as a single plan.

In determining the proceeds of the plan from dispositions of employer securities, the following dispositions are not taken into account: (1) distributions made on account of the death or disability of the employee, the retirement of the employee after the attainment of age 59-1/2, or a separation from service of the employee which results in a 1-year break in service; (2) certain exchanges of qualified employer securities for other employer securities in a corporate reorganization; and (3) dispositions required to meet diversification requirements (section 401(a)(28)).

This provision can be illustrated by the following example: On July 1, 1988, executor E sells employer securities to an ESOP. The proceeds of the sale are $150,000. During the 1-year period from

July 2, 1987, through July 1, 1988, the cost of employer securities acquired by the plan and all other ESOPs maintained by the employer (excluding the purchase from executor E) is $350,000. The proceeds of the ESOP (and all other ESOPs maintained by the employer) from the disposition of employer securities during the same period (excluding any dispositions excepted from the provision) is $400,000. The estate tax deduction is not available with respect to $50,000 of the proceeds received by executor E and is available with respect to $100,000.

Dispositions within 3 years following sale.—To preclude an ESOP from disposing of qualified securities within 3 years of the date of a sale qualifying for the estate tax deduction, an excise tax is imposed on the employer maintaining the ESOP. The tax is equal to 30 percent of the amount realized on the disposition. No penalty tax is imposed on dispositions which are excepted from the provision prohibiting dispositions within the one-year period preceding the sale. The amendment contains ordering rules for determining which securities are considered disposed of in any disposition.

The 30-percent excise tax does not apply to dispositions of securities with respect to which the estate tax deduction is denied due to a failure to meet the nonsubstitution requirement.

Failure to allocate.—The amendment imposes an excise tax on the employer maintaining the ESOP in the event of a failure to allocate securities acquired in a section 2057 transaction. The tax is equal to 30 percent of the amount realized on the disposition of qualified employer securities before the securities are allocated to the accounts of plan participants if the proceeds from such disposition are not so allocated. This excise tax is coordinated with the tax on distributions within 3 years following the sale, so that this tax does not apply to dispositions to which the premature disposition tax applies.

The tax applies in a number of situations to which the tax on premature dispositions does not apply. For example, the tax applies if the shares were disposed of after expiration of the 3-year period in order to repay an exempt loan.

Taken together with the 3-year rule, this provision requires that, within the 3-year holding period, employer securities are to be allocated to plan participants or held for allocation. After expiration of the 3-year holding period, the securities may be sold, but the entire proceeds of the sale (including any amounts owing on an exempt loan) are to be allocated to plan participants.

The 30-percent excise tax does not apply to dispositions of securities with respect to which the estate tax deduction is denied due to a failure to meet the nonsubstitution requirement.

Effective Dates

Confirmation of IRS Notice

Because this provision of the amendment accurately reflects Congressional intent in enacting the estate tax deduction, it is effective as if included in the Tax Reform Act of 1986.

Tax-credit ESOPs

This provision is effective as if included in the Tax Reform Act of 1986.

Nonpublicly traded stock

This provision is effective with respect to sales after February 27, 1987.

Estate requirements

Sale by executor.—This provision is effective as if included in the Tax Reform Act of 1986.

Limitation on deduction.—This provision is effective with respect to sales of employer securities to an ESOP after February 27, 1987. Sales on or before February 27, 1987, are not subject to the limitations in the provision, but are taken into account in determining whether the limitations are met with respect to post-effective date sales.

Holding period requirement.—This requirement is effective with respect to sales to an ESOP after February 27, 1987.

Assets transferred from other plans.—This provision is effective with respect to sales to an ESOP after February 27, 1987, and, in the case of transfers used to make payments on a loan, transfers used after February 27, 1987.

ESOP allocation requirements and substitution prohibition

Dispositions within 1 year preceding sale.—This provision is effective with respect to sales to an ESOP after February 27, 1987.

Dispositions within 3 years following sale.—This provision is effective with respect to dispositions of qualified securities by the ESOP after February 27, 1987. The 30-percent excise tax does not apply to dispositions of securities with respect to which the estate tax deduction is denied due to a failure to meet the nonsubstitution requirement.

Failure to allocate.—This provision is effective with respect to failures to allocate employer securities occurring after February 27, 1987.

ESTIMATED BUDGET EFFECTS OF REVENUE PROVISIONS

Provisions Approved by the Senate Finance Committee, Fiscal Years 1988–90

[In millions of Dollars]

Item	1988	1989	1990
I. Revenue Provisions:			
A. Accounting Provisions:			
1. Repeal cash method of accounting for farms with receipts over $25 million	2	36	38
1. Repeal vacation pay reserve	396	1,983	2,038
2. Repeal installment method for dealers	2,043	2,964	2,143
3. Require capitalization of pension past service liability	70	110	120
4. Repeal cash method of accounting for farms with receipts over $25 million	24	36	38
B. Estimated Taxes Provisions	1,580	779	371
C. Corporate Tax Provisions:			
1. Modify computation of earnings and profits for intercorporate dividends and basis adjustments (overrule Woods Investment Company case) (Includes binding contract rule.)	94	328	450
2. Denial of graduated rates for personal service corporations	75	125	140
D. Partnership Provisions: Portfolio income	77	127	170
E. Child and Dependent Care Credit: Deny credit for overnight camp expenses	11	106	112
F. Modify Pension Funding Rules [1]	679	1,502	992
G. Estate and Gift Taxes: 2-year freeze of 1987 rates	21	176	165
H. Excise Taxes:			
1. Telephone tax: 3-year extension	1,324	2,266	2,472
2. Collect diesel fuel and special motor fuels taxes on sales to retailer	208	230	200
3. Extend termination date for coal excise tax			
I. Employment Taxes:			
1. FICA tax provisions:			
a. Expand employer share of FICA tax to include all cash tips	184	281	302
b. and c. Expand FICA tax to inactive duty reservists, certain agricultural employees, family members, and group-term life insurance includible in wages	200	261	278
2. Railroad retirement taxes	144	182	183
3. FUTA tax: 3-year extension	715	1,009	1,033
J. ESOP Estate Tax Deduction	1,226	1,553	1,862
Subtotal, Revenue Provisions	**9,071**	**14,018**	**13,069**
II. User Fees:			
A. Internal Revenue Service Fees	46	60	60
B. Extensions and Increases in Certain Alcohol, Tobacco, and Firearms Occupational Taxes	167	106	106
C. Customs Service Fee	122	152	591

80-012 O - 87 - 5

Provisions Approved by the Senate Finance Committee, Fiscal Years 1988–90—Continued

[In millions of Dollars]

Item	1988	1989	1990
Subtotal, User Fees	**335**	**318**	**757**
III. Outlay Reduction:			
A. Debt Collection: 3-year extension	300	425	425
B. PBGC Premiums Increase	390	510	540
Subtotal, Outlay Reduction	**690**	**935**	**965**
Grand Total, Deficit Reduction	**10,096**	**15,271**	**14,791**

[1] Includes provisions to modify full-funding limitation and effects of Finance PBGC-related provisions to modify funding rules.

TITLE V—COMMITTEE ON GOVERNMENTAL AFFAIRS

TITLE V—CIVIL SERVICE AND GOVERNMENTAL AFFAIRS GENERALLY

The leadership and OMB have agreed to the following as GAC's portion of the leadership amendment:

A 2 percent pay raise for civilian and uniformed military in FY 1988 (this was part of the budget "summiteers" original agreement)—with language added to prevent Members of Congress from receiving the increase.

A delay on three-fourths of new 1988 capital expenditures by the Postal Service (USPS) for a saving of about $400 million in FY 1988, and a 2nd year saving of about $600 million in FY 1989. This deferral would apply to new obligations rather than those already under contract.

In order to make the capital saving "enforceable" or "scorable" as saving, the Postal Service would be required to deposit the money saved into the Civil Service Retirement Trust Fund. As the Postal Service does not now pay for the COLAs provided to postal retirees under the Civil Service Retirement System (CSRS), and these costs are paid by the U.S. taxpayers—such payments would reflect partial payment of USPS's unfunded retiree liability. The Postal Service would be required to pay the annual cash costs of COLAs for postal empoyees retiring after October 1, 1989.

In addition, USPS would be required to begin paying the full cost of retiree health insurance under the Federal Employee Health Benefits (FEHB) plan. USPS has been paying this cost for workers who retired after October 1, 1986. However, U.S. taxpayers have been paying the FEHB bill for postal employees who retired prior to that time. The Postal Service would pick-up approximately $400 million in additional annual FEHB payments, and for fiscal years 1988 and 1989, it would be required to absorb these additional costs without a rate increase. This absorption would be subject to GAO review and to penalty (in the case of noncompliance.)

The text of S. 908, with amendment, has also been added to the budget plan. Two minor amendments to the Program Fraud Civil Penalties Act have also been added.

Inspector General (IG) Provision

Amends the Inspector General Act of 1978 to provide for the establishment of five additional statutory inspector general at the Internal Revenue Service (IRS), the Department of the Treasury (except IRS), the Office of Personnel Management (OPM), the Federal Energy Management Agency (FEMA), and the Nuclear Regulatory Commission (NRC). In addition, the bill strengthens the internal audit and investigation functions is over ninety other federal agencies without creating additional statutory IG positions. The bill also makes uniform the IG semi-annual reporting requirements, oath and affirmation, authority, and other IG obligations and powers.

TITLE VII—COMMITTEE ON VETERANS' AFFAIRS

TITLE VII. VETERANS' PROGRAMS

A. Sale of Vendee Loans Without Recourse

Section 7001 of the bill would repeal the provision in section 2(a) of the recently-enacted Public Law 100-136 which restricts the VA from selling vendee loans without recourse unless the amount received is equal to an amount which is not less than the unpaid balance of the loan, that is, for 100 percent of par value.

Buyers of VA-acquired properties have two options available with respect to financing such purchases. They can pay cash (which they usually will obtain through a loan from a conventional lender), or, if they qualify under the VA's credit-underwriting criteria, the VA will finance the transaction and accept the buyer's promissory note -- known as a "vendee loan". Traditionally, the VA has sold these loans "with recourse" -- that is, with a repurchase agreement making the VA liable for a default on the loan.

Section 2(a) of Public Law 100-136 has the effect of prohibiting without-recourse sales regardless of whether such sales would be in the interest of the financial solvency and stability of the Loan Guaranty Revolving Fund (LGRF). This section is identical to section 16 of S. 1801/H.R. 2672 as passed by the Senate on October 30, which was not included in the compromise agreement on that legislation, the "Veterans' Home Loan Program Improvements and Property Rehabilitation Act of 1987", which was passed by the House on November 17 and by the Senate on December 4 and is currently awaiting the President's signature.

S. 1691, which was enacted as Public Law 100-136, was introduced by the Chairman and Ranking Minority Member of the Committee on Veterans'

Affairs, Senators Cranston and Murkowski, on September 16 in order to provide 90-day extensions of two provisions -- the 1-percent loan fee, discussed below, and the provisions of section 1816(c) of title 38 establishing the "no-bid formula" for determining whether the VA acquires, or does not acquire, at a liquidation sale the property securing a VA-guaranteed loan that is in default -- which had September 30, 1987, sunset dates established in section 2512(c)(2) of the Deficit Reduction Act of 1984 (Public Law 98-369) (known as "DEFRA").

S. 1691 was introduced as an interim measure, pending enactment of a comprehensive home loan bill -- such as S. 1801/H.R. 2672 -- for the purpose of preventing a substantial hiatus in the collection of the fee.

On October 1, 1987 -- the day after the fee and no-bid provisions had expired -- the House passed an amended version of S. 1691. The House-passed version provided in section 1, in lieu of the 90-day extension, a 46-day extension through November 15, 1987. It also contained in section 2 the provision to prohibit the VA permanently from selling vendee loans without recourse unless such loans are sold for par value. The House Committee leadership, during debate on S. 1691, indicated that if the short-term extension of the fee were not enacted they would not agree to reinstate it. Accordingly, despite the strong concerns of the Chairman and Ranking Minority Member of the Senate Committee regarding the inadvisability of this absolute prohibition, the Senate concurred in the House amendments on October 1, 1987. The President signed the bill on October 16, also expressing grave reservations about section 2.

The Congressional Budget Office (CBO) estimates that, as measured against the Gramm-Rudman-Hollings (GRH) sequestration baseline, this provision would achieve savings in budget authority and outlays of $800

million in fiscal year 1988 and $611 million in fiscal year 1989. According to the Senate Budget Committee staff's November 30, 1987, description of the Summit Agreement on Deficit Reduction, those savings would be $0.8 billion and $1.0 billion, respectively.

B. Loan Fee

Section 7002 of the bill would amend section 1829(c) of title 38 to extend for 2 years, until September 30, 1989, the current-law sunset date of November 15, 1987, for the 1-percent fee which is charged all veterans, other than those with compensable service-connected disabilities, obtaining VA-guaranteed or direct VA home loans and all persons obtaining VA loans ("vendee loans") to finance their purchase of a property from the VA. This provision is also included in section 13 of the compromise agreement on H.R. 2672/S. 1801 awaiting the President's signature.

The requirement for the collection of a fee -- originally 0.5 percent of the amount of the loan -- on VA home loans, in section 1829 of title 38, was enacted in section 406 of the Omnibus Reconciliation Act of 1982 (Public Law 97-253) for the 3-year period ending September 30, 1985. It was derived from legislation proposed by the Administration and introduced as S. 2379 on April 15, 1982, and included in the legislative recommendations which the Veterans' Affairs Committee submitted to the Budget Committee pursuant to the reconciliation instruction set forth in section 2(b)(7) of the Concurrent Resolution on the Budget for FY 1983 (S. Con. Res. 92). In 1984, in section 2511(b) of DEFRA, Congress increased the fee to 1 percent and extended it

through September 30, 1987. That date was extended by section 1 of Public Law 100-136 to November 15.

In its 1982 report accompanying S. 2774, this Committee stated:

> Loans guaranteed by the VA . . . offer several significant advantages not available through conventional mortgage transactions. The most important of these is the fact that the Government's guarantee obviates the need for substantial downpayments, by offering the lender comparable protection. In addition, VA guaranteed loans are available . . . at interest rates generally below prevailing market rates, accompanied by other investment safeguards applicable to conventional mortgage transactions. At present, there is no fee charged in connection with these loans comparable to the fee -- presently averaging between 3 and 4 percentage points on the total amount of the loan -- charged in connection with conventional mortgages. . . .
>
> The Committee believes that the VA Loan Guaranty Program provides a unique and invaluable service to veterans for whom the downpayment demands associated with a conventional mortgage would prove too great an obstacle to home ownership. The Committee is of the view that the imposition of the ... fee, with the option of financing, provided for in this section, represents a modest and not unreasonable burden to impose upon beneficiaries of these useful VA loan programs. (S. Rept. No. 97-504, pp. 247-48)

In its report on S. 1801, the Committee expressed its belief that, in light of the significant financial problems now facing the LGRF, these views are equally applicable. (S. Rept. No. 100-204, p.42)

The 1-percent fee would, based on the fiscal year 1986 average loan of $70,006, result in an average fee of $700 per loan. The exemptions from the fee included in section 1829(b) would be preserved for veterans entitled to receive service-connected disability compensation and for surviving spouses of veterans who died of service-connected disabilities, in keeping with the Committee's long-standing view as expressed in the report on S. 1801, that benefits for or on behalf of service-connected disabled veterans are and should continue to be the highest priority mission of the VA. (S.Rept. No. 100-204, p. 43.)

This legislation would leave intact the provision in section 1829(a) affording eligible veterans the option of paying the fee in cash at the time of settlement or of financing it as a part of the principal amount of the loan. If the veteran opts for the latter course, the fee is payable in its entirety by the lender to the VA at the time of settlement, and the veteran incurs the obligation to repay the principal amount of such fee, together with interest, under the same terms and conditions governing the veteran's obligation to repay the principal amount of the loan itself.

As expressed in the report on S. 1801, it remains the Veterans' Affairs Committee's intention to continue to review carefully the need for the fee in terms of both the short-term and long-term solvency and stability of the LGRF. (S. Rept. No. 100-204, p.43.)

The CBO estimates that, as measured against the GRH sequestration baseline, this provision would achieve savings in budget authority and outlays of $165 million in fiscal year 1988 and $221 million in fiscal year 1989. According to the Budget Committee staff document describing the Summit Agreement, this provision would achieve savings of $0.2 billion each year.

C. Vendee Loan Ceiling

Section 7003 of the bill would amend section 1816(d) of title 38 to increase for fiscal years 1988, 1989, and 1990, the proportion of properties, acquired by the VA after foreclosure on VA-guaranteed loans, which the VA is required to sell on a cash rather than vendee-loan basis from a minimum of 25 percent and a maximum of 40 percent to a minimum of 35 percent and a maximum of 50 percent. This provision is also included in section 6(a) of the compromise agreement on H.R. 2672/S. 1801, now awaiting Presidential action.

Section 1816(d) of title 38, United States Code, enacted in section 2512(a)(2) of DEFRA restricts the number of VA-acquired foreclosed properties which the VA may sell in any fiscal year on a vendee-loan basis to a maximum of 75 percent and a minimum of 60 percent of all VA sales of such properties in that year.

Prior to the enactment of section 1816(d), the proportion of properties sold on a vendee-loan basis averaged 87 percent. In fiscal year 1986, 66 percent of properties were sold on a vendee-loan basis.

Since the enactment of the statutory limit on vendee loan sales in 1984, the VA has been able to comply with the requirement to make at least 25 percent of its sales of acquired properties for cash without making substantial discounts in the cash price and therefore without great cost to the LGRF.

The CBO estimates that, as measured against the GRH sequestration baseline, this provision would achieve savings in budget authority and outlays of $83 million in fiscal year 1988 and $72 million in fiscal year 1989.

D. Construction of Provisions

Section 7004(a) of the bill would clarify that the provisions in title VII of the bill satisfy section 202 of the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 (Public Law 100-119), subsection (a) of which generally prohibits treating a law that transfers a receipt from one fiscal year to an adjacent fiscal year as altering the deficit or producing a net deficit reduction. Subsection (b) of that section provides that the subsection (a) prohibition "shall not apply if the law making that transfer stipulates that such transfer . . . achieves savings made possible by changes in program requirements . . . ." The Veterans' Affairs Committee-recommended legislation states that, for the purposes of these provisions, it achieves savings made possible by changes in program requirements, namely, by requiring a greater proportion of cash sales and a reduced proportion of Government loans.

Section 7004(b) of the bill would provide, in light of the possibility that certain provisions identical to those in sections 7002 and 7003 may be enacted -- as part of the compromise agreement on H.R. 2672/S. 1801 -- prior to the enactment of the bill, that identical provisions not be incorporated in title 38 of the United States Code twice.

TITLE VIII—COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

TITLE VIII--AGRICULTURE

BACKGROUND

H. Con. Res. 93 provided budget reconciliation instructions to the Committee on Agriculture, Nutrition, and Forestry, which required savings totaling $1.33 billion from the level of spending expected as of January 1987 in the 1988 fiscal year on programs under the jurisdiction of the Committee. Reductions in the amount of spending expected for the fiscal years 1988 through 1990 must total $5.838 billion. In addition, the Committee was instructed to raise revenues of $7.2 billion through the prepayment of Rural Electrification Administration Loans. The Committee met those targets. However, scored against more recent spending estimates, the original Committee proposals did not reduce the federal deficit.

It should be noted that between January and August of this year, projected costs associated with agriculture declined by $9 billion over fiscal years 1988-1990. These savings were due, in large measure to programs contained in the 1985 farm bill. In essence, the Agriculture Committee was not given credit by the budget process for programs which are working, programs which are reducing costs, programs which recognize the long term nature of agriculture, programs which are beginning to restore some health to agriculture.

Therefore, as the result of a meeting between Congressional leaders and the Administration, at the request of the leadership, the Committee has drafted additional proposals that further reduce agricultural spending by approximately $2.5 billion according to current estimates of federal expenditures for fiscal years 1988 and 1989. Relative to projections of agricultural spending made in January of this year, the cost of the agricultural programs will now decline by more than $8.9 billion in fiscal years 1988 and 1989 alone.

SUMMARY OF THE TITLE

This title provides for changes in five main farm program areas: income support levels, acreage reduction programs for feed grains, whole base bid diversion program, loan programs, and Rural Electrification Administration lending programs. A summary of the provisions contained in the agricultural title is set out below.

SUBTITLE A--AGRICULTURAL PRICE SUPPORT PROGRAMS

AGRICULTURAL PRICE SUPPORT REDUCTIONS.

The title amends the Agricultural Act of 1949 (the "1949 Act") to provide for an additional reduction of 1 percent in the target price level for the 1988 crops of wheat, feed grains, upland

cotton, and rice. It is important to note that this 1 percent reduction in the target price is in addition to reductions in the target price already scheduled to take effect for the 1988 crop year.

Expenditures under the milk price support program for 1988 will be reduced by an amount which is equivalent to a 1 percent support price reduction; the funds will be generated through an assessment equal to 2.5 cents per hundredweight on all milk produced in the United States and marketed by producers for commercial use. The assessment will be in addition to the 4.5 percent reduction in the price support level scheduled for January of 1988, if the Secretary projects that purchases will exceed the trigger levels established under the 1985 Farm Bill. There will be no additional assessments for calender year 1989.

The emergency economic situation which prompted this action will cut additional funds from the dairy program, even though it has already achieved significant savings over the past year. As a result of the Food Security Act of 1985, the cost of the dairy program has been cut from $2.2 billion last year to under $1 billion this year. Surplus stocks have been dramatically reduced, and supply and demand are in better balance. Further cuts in this program could threaten the economic survival of thousands of our nation's dairy farmers.

The support price for wool for 1988 is also reduced by 1 percent.

LOAN RATES.

The 1949 Act is amended to provide that loan rates for the 1988 crops of wheat, feed grains, upland cotton and rice may decline by only 1 percent from 1987 levels. Current law would permit a 5 percent decline in such loan rates. The 1 percent limit is only for the 1988 crop year. Loan rates for the 1989 and 1990 crops retain a 5 percent limit on any decline.

STORAGE EXPENDITURES.

The Commodity Credit Corporation is required to reduce its total expenditures for commercial storage, handling, and transportation of CCC owned commodities over fiscal years 1988 and 1989 by a total of $230,000,000 from what would have otherwise occurred. This will be accomplished by lowering payment rates for these activities and by taking other actions.

WHOLE BASE BID PROGRAM.

A program is established for each of the 1988 and 1989 crops of wheat, feed grains, upland cotton, and rice under which producers may agree to retire the producers' entire base acreage for a crop in return for a base diversion payment. The amount of payments

made under this program will be determined through the submission of bids for base diversion contracts by producers in such manner as the Secretary may prescribe or by such other means as the Secretary determines appropriate. The program contains limitations on the amount of acreage in any county that may be retired. Payments under this program will be made at the same time in and in the same manner as deficiency payments.

ACREAGE LIMITATION PROGRAM FOR FEED GRAINS.

This provision requires the Secretary to increase by 5% the maximum acreage limitation required for a producer to be eligible for program benefits for the 1988 and 1989 crops of feed grains under the 1949 Act. A producer receives no direct payments for the land idled under this program. If the Secretary increases the acreage limitation by this 5%, the Secretary must allow a producer to plant oilseeds (soybeans, sunflowers, other oilseeds specified by the Secretary, but not cottonseed) on such idled acreage. The producers' feed grain crop acreage base is protected. The Secretary may waive this 5% increase in the acreage limitation program for the 1989 crop of feed grains if it is determined to be necessary in order to maintain adequate stocks of feed grains or to ensure that stocks of soybeans are not excessive.

Further, in the case of the 1989 crop of feed grains, if 1989 soybean stocks are estimated to exceed 425 million bushels, soybeans may not be planted on the additional idled acreage. However, in that case, the additional acreage limitation requirement may only be 2.5 percent.

This section also provides that, in the case of the 1988 through 1990 crops of oats, the Secretary of Agriculture shall not establish an acreage limitation requirement in excess of 5 percent. This requirement may be waived in the case of the 1990 crop of oats if the Secretary determines that the supply of oats will be excessive. The Secretary is required to issue regulations that provide for the fair and equitable treatment of producers on a farm for which an oat and barley crop acreage base has been established. This provision will lower barley stocks, lower oat imports, and generate budget savings.

The Secretary has interpreted the Food Security Act of 1985 as requiring the same acreage reduction for both the oat and barley programs. The base acreage for barley and oats are combined, a program feature which is retained by this amendment. While the variable production costs and yields for the two crops are similar, the target price for barley is approximately one dollar per bushel higher than oats. Because of the target price differential, the returns from planting barley are $25-$30 per acre higher than from planting oats.

Harvested oat acreage has declined every year since 1980, falling from 10.3 million acres to 7 million acres in 1986. It is estimated to have increased only slightly to 7.3 million acres in 1987. The United States is now importing 30-35 million bushels of oats annually.

In contrast, harvested barley acreage has increased since 1980, reaching 13.2 million acres in 1985. Harvested acreage fell in 1987 due to acreage reductions resulting from strong program participation by producers of barley. Over 120 million bushels of barley remain in the Farmer-Owned Reserve. Four million bushels of oats are held in the same category.

If the acreage reduction requirement for oats is lowered to 5 percent, the difference in returns between barley and oats falls to $10-$15/acre. This change should provide the barley/oat producer with some incentive to shift acres out of barley and into oats, which will lower barley stocks and oat imports.

PAID LAND DIVERSION PROGRAM FOR FEED GRAINS.

This provision amends the 1949 Act to provide that if the Secretary implements a paid land diversion program for the 1988 or 1989 crop of feed grains, the maximum amount of the diversion shall be 5%. For the 1988 crop, the payment rate shall be $2.00 per bushel. For the 1989 crop, the payment rate shall be $1.75 per bushel. However, if the Secretary does not implement the additional 5 percent acreage limitation program for feed grains, but instead implements the 2.5 percent program, the paid land diversion program for the 1989 crop of feed grains would be 7.5 percent with a payment rate of $1.75 per bushel.

LOAN PROGRAMS FOR SOYBEANS AND OTHER OILSEEDS.

A marketing loan program is mandated for the 1988 and 1989 crops of soybeans and sunflowers. Under this program, producers of these commodities could repay a price support loan at the prevailing world market price for the commodity, as determined by the Secretary of Agriculture. In establishing the formula for determining the prevailing world market price for soybeans and sunflower seed, the Secretary should ensure that these commodities are competitive on the world market. The Secretary should take into consideration the prevailing prices for these commodities in major world trading centers and the impact import restrictions and subsidies have upon world prices of these commodities.

The loan rate for soybeans is established as under current law. The provision establishes the support price for sunflowers at 8 cents per pound for the 1988 through 1990 crops.

The Secretary of Agriculture is directed to support the price of the 1988 and 1989 crops of cottonseed at a level and such manner as the Secretary determines is fair and reasonable in relation to the level and manner in which the price of soybeans is supported.

ADVANCE PAYMENTS.

This provision amends section 107C of the 1949 Act to provide that, for the 1988 through 1990 crops of wheat, feed grains, upland cotton, and rice, if the Secretary of Agriculture determines that deficiency payments will likely be made for any of such commodities, the Secretary shall make deficiency payments available in advance to producers of these commodities. The Secretary shall make no less than 40 percent of the expected wheat and feed grains deficiency payments and no less than 30 percent of the expected cotton and rice deficiency payments in advance.

Under section 107C(a) of the Food Security Act of 1985, the Secretary can pay up to 50 percent for wheat and feed grains and 40 percent for rice and cotton of estimated deficiency payments in advance. No minimum level is specified. Advance payments mandated by this amendment will help farmers reduce the costs of financing their crops at the beginning of the season. Mandating these advance payments for FY 1988-1990 will provide some assistance in financial planning in future years.

ADVANCED EMERGENCY COMPENSATION PAYMENTS FOR WHEAT.

This provision amends section 107D of the 1949 Act to require the Secretary of Agriculture to estimate by December 1 of each of the marketing years 1988 through 1990 the national average market price per bushel of wheat received by producers during each of such marketing years. The Secretary shall, by December 15 of each such marketing year, make 90 percent of the estimated final wheat deficiency payment available to producers who have elected this payment option. In the case of the 1987 marketing year for wheat, the Secretary must make such estimate as soon as practicable after the date of enactment of the Agricultural Reconciliation Act of 1987 and must make such advanced payments available within 60 days after the date of enactment of the Act.

For the 1987 crop of wheat, producers may elect the payment option under this section no later than 30 days after the date of enactment of the Agricultural Reconciliation Act of 1987. For the 1988 through 1990 crops of wheat, producers must elect this payment option at the time of signup. Under traditional tax rules, producers would be attributed income in the year in which the payment is received.

The estimated payment provided for by this amendment would be based upon the Secretary's projection of the season average price for each year. The balance of such payments, if any, would be made at the end of the marketing year.

PRODUCER RESERVE PROGRAM.

This provision amends section 110 of the 1949 Act to provide that the minimum quantity of wheat and feed grains that must be stored in accordance with the producer reserve program is 300 million bushels for wheat and 450 million bushels for feed grains. Current law directs the Secretary to provide incentives to producers to place grain in long term storage programs if the amount of grain stored under these programs falls to less than 17% of total use for wheat and 7% of total use for feed grains.

HONEY LOANS AND PAYMENT LIMITATIONS.

The provision would reduce the loan rate for honey for each of the 1987 through 1990 crops as follows: 2 cents per pound for the 1987 crop, 3/4 cent per pound for the 1988 crop, 1/2 cent per pound for the 1989 crop, and 1/4 cent per pound for the 1990 crop.

The limitations on (1) the amount of honey which can be placed under loan at any one time and (2) the amount of gain received by a honey producer under the marketing loan program are removed. The section provides that the maximum amount of honey which can be forfeited to the government may not exceed $250,000 for any crop.

LOAN RATE DIFFERENTIALS.

This provision amends section 403 of the 1949 Act to restrict the degree that state, region, or county loan rates may be adjusted to reflect transportation and other differentials. The section limits such adjustments to the percentage change in the national average loan rate plus or minus 1 percent.

Under current law, the Secretary may raise or lower an individual county loan rate to reflect differences in transportation costs and other factors. Earlier this year, the Secretary adjusted virtually all county differentials, voluntarily limiting any reduction to no more than five percent. In addition, the Food Security Act of 1985 mandated a five percent reduction in the national average loan rate.

In some counties the combination of the national loan rate decline and the differential adjustment reduced loan rates in excess of the five percent anticipated under the 1985 Act. For example, the decline in wheat loan rates in Oklahoma, North Dakota, and South Dakota was about eight percent. In other

states the combination produced an overall reduction in loan rates of less than five percent; in Kansas, the wheat loan rate declined by less than four percent.

Many producers have made plans for their farm operations based on loan rates anticipated under the Food Security Act of 1985. Unexpected discretionary reductions in loan rates should be avoided or at the very least minimized. The limit on the Secretary's discretion under this section is intended to accomplish this end.

YIELD ADJUSTMENTS.

The provision will protect producers from dramatic declines in the calculated farm program payment yield. This protection will extend through the 1990 crop year. Producers will be compensated if the calculation of farm program payment yields provided for in the Food Security Act of 1985 causes such producers' program yields to fall more than 10 percent below the producer's 1985 farm program payment yield.

Section 506(b)(2) of the 1949 Act would be amended to provide that in the case of each of the 1988 through 1990 crops of wheat, feed grains, upland cotton and rice, if the farm program payment yield for a farm is reduced more than 10 percent below the farm program payment yield for the 1985 crop year, the Secretary shall make available to producers established price payments for the commodity. These payments shall be made in such amounts as the Secretary determines is necessary to provide the same total return to producers as if the farm program payment yield had not been reduced more than 10 percent below the farm program payment yield for the 1985 crop year.

Such payments shall be made available to producers at the time that the final deficiency payments under the wheat, feed grains, upland cotton, and rice programs are made available to producers.

Under current law, the Secretary may determine program payment yields by averaging the farm program payments yields for the years 1981-1985 or by calculating a five year rolling average of the yield per harvested acre for each crop a producer enrolls in a Federal farm program. The Secretary has chosen the former method for the 1986, 1987, and 1988 crops.

Producers were compensated for reductions in program payment yields beyond three percent in 1986, and five percent in 1987. The policy of providing farmers with reimbursement expires with the 1987 crop. Producers should receive compensation for reductions of more than 10 percent in the farm program payment yields.

SUBTITLE B--PREPAYMENT OF RURAL ELECTRIFICATION LOANS.

PREPAYMENT OF LOANS.

This provision amends Section 306A of the Rural Electrification Act of 1936 to allow Rural Electrification Administration ("REA") borrowers to prepay loan advances to the Federal Financing Bank. A processing fee will be charged on each prepayment; the fee is calculated by adding 50 basis points plus points equal to 50 percent of the difference between the interest rate on the loan advance being prepaid and the cost of money to the government at the time of prepayment. Charges in addition to principal and processing fee are expressly prohibited.

The borrower may, at its option, amend the existing guarantee to include the amount of the principal balance prepaid, the amount of the processing fee, and the cost to the borrower of obtaining private capital. Borrowers who already had been determined by REA to be eligible to prepay in fiscal year 1987 or who had already prepaid, may prepay any advance received from the FFB and not prepaid by the date of enactment of this Act under any combination of terms and conditions applicable to such prepayments under section 306A of the Rural Electrification Act of 1936 as in effect prior to the amendment made by this section or as amended by this section.

USE OF FUNDS.

This provision amends Title III of the Rural Electrification Act of 1936 by adding a new section which allows an REA borrower to invest its own funds or to make loans or guarantees not in excess of 15 percent of its total utility plant.

This change in use of funds will allow rural cooperatives to meet needs in their communities beyond providing electric service. Cooperatives are in a position to advance the development of distressed rural areas. They have demonstrated their capacity for development by facilitating water and waste disposal projects, as well as rural business development. This provision would lift a current administrative restriction which limits a borrower's investment in non-Act purposes to 3% of total utility plant and replace it with a 15 percent limit.

CUSHION-OF-CREDIT PAYMENTS PROGRAM.

This provision allows REA electric and telephone borrowers to make voluntary advance payments to cushion-of-credit accounts within the Rural Electrification and Telephone Revolving Fund ("Fund"). A borrower may reduce the balance of its cushion-of-credit account only to make scheduled payments on loans made or guaranteed under the Act.

Amounts in these accounts will earn 5% interest for the REA borrower from REA; meanwhile, all cash balances held by the Fund will bear interest to the Fund at the average rate on certificates of beneficial ownership issued by the Fund. Income from this interest differential will flow into a special Rural Economic Development Subaccount within the Fund. The Administrator is authorized to make grants or zero interest loans to borrowers to promote rural economic development and job creation projects. Such loans and grants shall be made during each fiscal year to the full extent of the amounts held by the subaccount.

This program will render REA's lending position more secure because a borrower's advance payment into the cushion-of-credit account may be used in the future in lieu of a loan payment to REA.

RURAL TELEPHONE BANK.

This provision requires that the Rural Telephone Bank ("RTB") apply its most current cost of money rate at the time of each advance on future loans. This section also allows an RTB borrower to prepay a loan during fiscal year 1988 without paying prepayment penalties set forth in the note covering such loan. The Governor of RTB is directed to issue regulations to carry out this amendment; such regulations may not further restrict participation in these programs.

Existing statutory authority directs RTB to set its interest rates at its cost of borrowing and to carry out its operations in a self-sustaining manner. According to a financial audit by the General Accounting Office, RTB's interest rates have exceeded its cost of borrowing, resulting in accumulated earnings of some $60 million over the 1984-86 period. The Agriculture Committee specifically disapproved of this practice.

By applying the interest rate at the time of advance rather than at the time of commitment, RTB will in the future apply a rate much closer to its cost of borrowing. By allowing RTB borrowers to prepay without penalty, this provision will provide some relief to borrowers. It is the intention of the Agriculture Committee that the Governor of RTB add no further restrictions to borrowers' prepayment and no further restrictions to application of interest rates at the time of advance.

SUBTITLE C--MISCELLANEOUS

STUDY OF USE OF AGRICULTURAL COMMODITY FUTURES AND OPTIONS MARKETS.

The study on the use of commodity futures and options markets, authorized in the Food Security Act of 1985, was originally to be completed in 1988, is now to be completed in 1989.

AUTHORIZATION OF APPROPRIATIONS FOR PHILIPPINE FOOD AID INITIATIVE.

This section amends section 416 of the 1949 Act to authorize $1 million to be appropriated for technical assistance for the sale or barter of commodities to strengthen nonprofit private organizations and cooperatives in the Philippines.

RURAL INDUSTRIALIZATION ASSISTANCE.

This provision amends section 310B(c) of the Consolidated Farm and Rural Development Act by allowing private nonprofit corporations to participate with public bodies in a grant program to finance and facilitate development of small and emerging private business enterprises.

Private nonprofit corporations should be included as recipients in this grant program because nonprofit community development corporations across the country have demonstrated their ability to successfully foster economic development in distressed rural areas. By financing small and emerging businesses, this program can work more effectively to stimulate job growth in rural communities.

PLANT VARIETY PROTECTION FEES.

This section amends section 31 of the Plant Variety Protection Act to provide that the Secretary of Agriculture shall charge and collect reasonable fees for the services performed under the Plant Variety Protection Act. The section authorizes the Secretary to charge a late payment penalty for overdue fee payments.

All fees, payment penalties, and collected interest shall be credited to the account that incurs the cost and shall remain available without fiscal year limitation to pay the expenses incurred by the Secretary in carrying out the Plant Variety Protection Act. These collected funds may be invested by the Secretary in certain specified accounts.

The Attorney General may bring an action for the recovery of charges that have not been paid in accordance with the Plant Variety Protection Act against any person obligated for payment of such charges under such Act.

The Plant Variety Protection Program is entirely voluntary. It provides patent-like protection for a period of 18 years to developers of new varieties of plants. Fees currently charged to participants in this program are now placed in miscellaneous Receipts of the Treasury.

An account should be established, in which fees, late payment penalties and accrued interest collected from the account may be deposited. The fee and penalty structure will be established by the Secretary.

In making this recommendation, it is important that the fee and penalty schedule not be structured in such a way as to preclude, or discourage participation in the program.

ANNUAL APPROPRIATIONS TO REIMBURSE THE COMMODITY CREDIT CORPORATION FOR NET REALIZED LOSSES.

This section amends section 2 of the Commodity Credit Corporation Charter Act to provide for the funding of the operations of the Commodity Credit Corporation by means of a current, indefinite appropriation. This action is being taken to prevent disruptions in producer payments and commodity loan availability from the Commodity Credit Corporation.

This section also provides that no funds may be appropriated for operating expenses of the Commodity Credit Corporation except as authorized under section 2 of Public Law 87-155 to reimburse the Corporation for net realized losses. Operating expenses of the Corporation include all expenditures of the Corporation made in carrying out its activities, including those under the annual commodity programs authorized under the 1949 Act and the Agricultural Adjustment Act of 1938.

FEDERAL CROP INSURANCE.

This section provides that it is the sense of Congress that the Federal Crop Insurance Corporation should not be required to assume 100 percent of all loss adjustments in the Federal Crop Insurance program. The report accompanying H.R. 3520, which makes appropriations for Rural Development, Agriculture, and Related Agencies for fiscal year 1988, directs the Corporation to assume 100 percent of all loss adjustment in the Federal Crop Insurance program and to amend agreements with reinsured companies accordingly. The Corporation should be given the opportunity to improve oversight of loss adjustments by reinsured

companies. Transferring all responsibility for this activity in the middle of the contract year would be disruptive.

The section further states that the Corporation should assume and perform the loss adjustment obligations of a reinsured company if such company's loss adjustment performance is not carried out in accordance with the applicable reinsurance agreement.

ETHANOL USAGE.

This section contains certain findings of Congress concerning the use of ethanol as a source of motor fuel including findings that ethanol can be blended with gasoline to produce a relatively clean source of fuel; ethanol can be produced from grain, a renewable resource that is in considerable surplus in the United States; and an increase in the quantity of motor fuels that contain at least 10 percent ethanol from current levels to 50 percent by 1992 would create thousands of new jobs in ethanol production facilities.

The section provides that it is the sense of Congress that the Administrator of the Environmental Protection Agency should use the authority provided under the Clean Air Act to require greater use of ethanol as a motor fuel.

O

ERRATA

The table on page 11 of the Leadership Amendment to S. 1920, The Omnibus Budget Reconciliation Act of 1987, displaying the *defense and nondefense discretionary spending limits* should be:

	1988	1989
Defense (050):		
Budget authority	292.0	299.5
Outlays	285.4	294.0
Nondefense:		
Budget authority	162.9	166.2
Outlays	176.8	185.3

The last paragraph beginning on page 118 should be:

The Congressional Budget Office estimates that, as measured against the Gramm-Rudman-Hollings sequestration baseline, this provision would achieve savings in fiscal year 1988 of $611 million in outlays. According to the Senate Budget Committee staff's November 30, 1987, description of the Summit Agreement on Deficit Reduction, the savings in outlays would be $0.8 billion in fiscal year 1988 and $1.0 billion in fiscal year 1989.

The last paragraph on page 113 on the *Inspector General provision* should be deleted.

○